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The Rationale of the Social Services

By Walter Hagenbuch

UNTIL recently it was widely assumed that the aims and ends of the social services were generally understood and accepted and that the problems which gave such headaches to the politicians were problems of means. Had not Beveridge pointed the way for us with Bunyanesque simplicity and fervour? We were out, he said, to attack five giants on the road of reconstruction. Their names were Want, Disease, Ignorance, Squalor and Idleness, and he gave us an armoury of weapons sufficient for the most faint-hearted pilgrim: social insurance, family allowances, national assistance, a comprehensive health service and a full employment policy, with the voluntary services as a sort of flying squad to fill odd gaps in the ranks and deal with special cases for which the State services were inappropriate.

We hardly expected that such a programme could be carried out without difficulty, but for a long time we went on discussing the problems that arose as problems of means, as questions of organization and finance which the politicians would solve by seeking the advice of expert administrators, cost-accountants and perhaps even economists. Discussion of the social services is now becoming more and more a discussion about ends. Both inside and outside the House of Commons there is a growing body of opinion that before we can answer the question "How can we control the cost and increase the efficiency of the social services?" we must first answer the questions "What are the social services for, and where are we going with our programme of social security?"

This matter of aims and objectives is really a matter of perspective; and the burden of this article is that there is not only a choice of aims but a different set of aims according to how far ahead we care to look. We shall first set out the short-term aims of policy, the considerations, that is, which have in fact dominated political discussion at the time of the budget. We shall then lift our eyes from the Finance Bill, so to speak, and look out, as the Chancellor occasionally permits himself to do and as his opponents delight to do, into the middle distance. There we can discern a little group of social objectives, or, to use the current jargon, a little procession of sacred cows. These are the objectives, some of them mutually compatible, some not, amongst which we must choose if our short-term policy is to be justified. Finally we shall gaze out into the far distance and see there two fundamentally conflicting

philosophies of the Welfare State, the choice between which may well determine the future not only of the social services but of our whole economic and political society.

I
THE SHORT-TERM CONSIDERATIONS

Recent adjustments in the finance of the social services have been governed by three principal considerations. First, there was the obvious need for more elbow-room in the budget. By 1949 social services expenditure, including subsidies of all kinds, accounted for nearly 40 per cent. of total central government expenditure. This proportion is by itself of some significance, but the fact that it was a growing proportion made the Chancellor's task exceptionally difficult. Budget decisions are essentially marginal decisions—matters of spending a bit more here and saving a bit more there—and the health services and the food subsidies were clearly crowding out non-social-service expenditure.

Secondly, there was the need to choke off demand for scarce resources. Ministers have admitted quite freely that they hoped to reduce the demand for spectacles, prescriptions and dental services, although we had been told that people's need for these commodities was assessable on medical grounds and ought not to be dependent on their price. Mr. Macleod himself said in March, 1952:

> It can be argued that a deterrent charge for health is an advantage provided, and only provided, that a switch of resources follows. It was because of that that the Leader of the Opposition justified the "bob on prescriptions" as it is called, in order to reduce the queues at surgeries and free the doctors. If that switch can take place, and I recognize that there are differing views about it, it seems to me that these charges are overwhelmingly justified, not only economically, but socially and medically as well.

Thirdly, there was the need to maintain a reasonable relationship between insurance and assistance payments and the cost of living. Inflation was not one of Beveridge's giants, but it ought to have been; for in time of rising prices the Chancellor is faced with an unfortunate dilemma. If he does not increase benefits as the cost of living rises, the pensioners and the unemployed will be reduced to poverty; if he ties the benefits to the cost of living, both the budgetary problem and the inflation itself will be aggravated.

Clearly we cannot make any sensible decisions on the basis of short-term considerations alone, however dominant these may appear to be at the time. If, for example, we decide to limit absolutely the cost of the Health Service and the amount of the food subsidies, we solve the budgetary problem but we

incidentally make fundamental decisions about the purpose of these services.

Let us analyse the statement quoted above that "a deterrent charge for health is an advantage provided that a switch of resources follows" and apply it to the case of a uniform charge for the cost of dental treatment up to a maximum of one pound per year. Suppose first that the demand proves elastic and falls substantially because people had been abusing the "free" service. They had conspired with the dentists to obtain treatment and dentures which they did not urgently need. In this case there is no conflict of aims: we relieve the budget, we release scarce resources, and we do no harm to the consumers.

Now suppose that the demand proves elastic and falls substantially because people who need such treatment cannot now afford it. Such people can be described as in primary poverty; that is, a condition in which their income is not sufficient to provide for their minimum needs. In these circumstances we are subordinating one aim of economic and social policy, namely the relief of poverty, to two others: the easing of pressure on the budget and the release of the scarce resources embodied in dental equipment and manpower.

Now suppose again that the demand proves elastic and falls substantially, this time because people who need treatment, although they could afford it, choose to go on spending their money on other things. Such people may be described as in secondary poverty. Their income is sufficient to provide for their needs but they spend it unwisely and to the detriment of their health. Again we are putting the relief of secondary poverty lower in our priority list of social and economic aims than the release of the scarce resources and the removal of pressure on the budget.

Suppose, however, that the demand proves inelastic and that people consume as much dental service as before but, having to pay for it, spend less on other things, which may or may not be "scarce." We achieve the aims of relieving the budget and reducing the pressure of demand for furniture or television sets or house repairs, but we introduce two new principles of social policy: one, that charges for social services should be uniform and not related to the incomes of the recipients; two, that charges should be levied on services for which the demand is inelastic. "No one will be hurt by having to pay for the first pound of treatment" is the rough justification of this policy.

Finally, suppose that people consume as much dental service as before, but that those who cannot afford it recover

their pounds from the National Assistance Board. We are still accepting the relief of poverty as an essential aim, but instead of discriminating by type of service (i.e. levying charges where they " will not hurt anybody ") we now discriminate between those who can and those who cannot afford to pay—we introduce a means test.

II
THE LONGER-TERM AIMS OF POLICY

Our case study has thrown up a somewhat confusing array of objectives, the reconciliation of which must determine our policy in regard to the social services. The task of reconciliation is the unfortunate lot of the politician. We who sit in the gallery, or watch these things from a college window in Cambridge, can assist him in two ways: by pointing out that there *are* several objectives which may not be mutually compatible, and by setting them out in an orderly manner and indicating the appropriate policy in each case. The need for such a sorting out was never more apparent than in the discussion about food subsidies which took place in the Press, and especially in the correspondence columns of *The Times*, during the 1951 election. It was like a discussion among army officers about whether or not to scrap an anti-aircraft gun in which one says yes, because it is useless for shooting rabbits, another says no, because it could be used for shooting duck, and a third whispers that after all it was originally intended for shooting aircraft.

We can in fact reduce the aims of social policy to five: The first and most widely accepted is the relief of primary poverty, or, to use Beveridge's words, the removal of want. The task of the social services then falls into three parts: to decide where the poverty line shall be drawn, to discover who is below it, and to bring them up to it or just above it.

Our ideas about the poverty line and the subsistence level may vary from time to time and place to place, but the level has to be determined with caution; for wherever we draw it, we find that there are large numbers of people living not very far above it, so that by raising it we tend to increase disproportionately the number of claimants for benefit and the total cost of relief. In 1936, for example, Rowntree found that by raising it from about 40s. per week to 53s. per week for a family of five he increased the incidence of poverty in York from 6·8 per cent. to 31·1 per cent. of the working population.

For the next task, that of discovering who is below the poverty line, the assessment may be made on an individual basis or by categories. Individual assessment may be more

efficient because it aims at establishing the precise amount of benefit that is necessary to relieve poverty in each case, but it involves unpopular means tests and takes up the time of a rare type of official, the skilled relieving officer. Assessment by categories is the method of national insurance—we find from the social surveys that the principal causes of poverty are sickness, unemployment, old age and large families; and we pay, through the routine machinery of the Ministry, standard benefits to any person who can show that he falls into one of these categories. Some will receive benefits who are not actually in poverty; some who are in poverty will not receive them and will go to the Assistance Board as special cases. But by and large social insurance relieves poverty with reasonable efficiency.

The main point is, however, that once we accept the relief of poverty as an over-riding aim, any cut in the social services must take the form of either lowering the poverty line or discriminating more effectively between those who can and those who cannot afford to pay for the means of subsistence. A means test, in the widest sense, becomes a logical and an essential instrument of policy.

Much the same is true of the second aim, the relief of secondary poverty, which lies at the root of the health and education and welfare services. Here the social services are provided in kind, not so much because the beneficiaries could not afford them (if such were the case there would be no reason for not providing them in cash) but because the State thinks it knows better than the individual what is good for him. Again, the efficiency of the services must be judged by the precision with which they assess and supply people's needs, and any cuts in the cost of the services must take the form either of a stricter assessment of needs (e.g. by putting up the standard for entry to higher education) or of discrimination between those who can *and will* provide adequately for their own doctoring and schooling and those who cannot or will not.

Thirdly, it appears to be an aim of the social services to promote greater equality of incomes. This is a fascinating and modern development. No social service was ever set up with the avowed object of promoting income equality or justified originally on this ground, but there has grown up in recent years a band of equalitarian crusaders, well represented in the House of Commons and the Press, who are stubbornly antipathetic to any measure that works "regressively," and judge the social services by that criterion alone.

The most extreme manifestation of this attitude is the complaint that people who do not pay any taxes obtain no relief

when taxation is reduced. In regard to the social services it takes the form (which is not as paradoxical as it seems) of opposition to equality of sacrifice. We are told, for example, that it is wrong to charge anybody one pound for dental treatment because the rich could afford more, that it is wrong to reduce the food subsidies because the rich spend very little on bread, and so on. Of course, the relief of poverty must necessarily involve some redistribution of income, but the relief of poverty and the pursuit of equality are not the same thing. If we accept the latter as an over-riding aim we impose much more severe limitations on the Chancellor when he decides to spend more or less on the social services, or to modify their structure in any way.

Fourthly, there are those who regard the social services as primarily a means of socializing the national income: of providing free, universal and equal benefits for all, irrespective of their needs and means. This aim was most vigorously put forward in defence of the food subsidies, but it applies equally to any kind of " basic ration " or " social dividend." We shall say more about this in the next section. For the present we need only stress that, if this objective is regarded as paramount services which confer different benefits on different individuals or categories are out of place. On this basis, no service can be called wasteful or inefficient on the ground that it benefits the rich as well as the poor. If the services have to be cut, we must reduce the bread ration all round; if expanded, we must increase it all round. No one must have a free orange unless everyone can have it, and there can no longer be any question of applying cuts in the services where they will hurt least.

Finally, the social services may be used for the support of general economic policy. In this case they must be subordinated to it, and the other criteria (relief of poverty, etc.) may have to be abandoned. Most of us would probably maintain that the social services ought to stand in their own right and not become the handmaid of general economic policy, except in the broad sense that they may be too large in relation to the national income. But it was part of the Beveridge proposals, and it is written into Section 4 of the National Insurance Act, 1946, that insurance contributions may be adjusted to implement employment policy. This is the famous " thermostat " principle, by which in time of depression the Treasury would lower insurance contributions and encourage us to spend, and in time of boom would raise them and force us to save.

We now doubt the efficacy of this principle and it will probably never be put into practice. The saving and spending

might not be as automatic as the theory assumes, and in time of boom the raising of employers' costs and the impetus to wage claims would aggravate the inflation. Nevertheless, the danger of inflation has been invoked time and again in justification of adjustments to the social services. The manipulation of pension rates in order to encourage people to remain at work, the use of National Insurance Funds to buy up Government loans, and the arguments discussed above in connection with the budget are all examples of the subservience of the social services to the needs of general economic policy.

It only remains to say that, though some of these aims may be mutually incompatible, they are not mutually exclusive. It is, of course, possible to adopt compromise policies in regard to the social services which give us a mixture of discriminate and indiscriminate benefits, a measure of poverty relief combined with concessions to economic policy or equalitarian sentiment, and so on. Our purpose has been merely to separate out the different aims in order to clarify discussion and avoid the kind of argument in which people uphold different policies because, without realizing it, they are making different assumptions about the aims of policy.

III

THE FUNDAMENTAL LONG-TERM PROBLEM

If we now look still further ahead, we find that beyond our short-term and intermediate aims there is a long-term question which has been neglected and cries out for serious discussion lest we answer it by default. What is to be the eventual place and purpose of the social services in our society? The only answers in recent times have been given by the sociologists and by those who, for want of a better name, might be called community-idealists. For the economist there are three possible points of view on this matter. The first is that the social services should, in the long run, be self-liquidating. The second is that they should be a permanent but not a pervasive feature of our society, a means of dealing with problems of maladjustment and abnormality, like a police force in a largely law-abiding country. The third is that they should be an all-pervasive and a growing feature of our economic life.

Fifty or a hundred years ago most economists would have supported the first point of view. Professor Robbins has reminded us in his recent book, *The Theory of Economic Policy*, that Senior, while admitting that there should be permanent State help for certain special classes, such as the blind and the insane, regarded other forms of State relief as justifiable only if they brought people as quickly as possible to a condition in

which they would no longer require State relief. He regarded even State aid to education as self-liquidating in the sense that after the first generation or two had received education, parents would appreciate its value for their children and give it due importance with food, clothing and shelter in the family budget.

Here is a quotation from Senior's *Suggestions on Popular Education*[1] submitted to the Royal Commission in 1861 :—

> We may look forward to the time when the labouring population may be safely entrusted with the education of their children ; but no Protestant country believes that this time has come and I see no reason to hope for it until generation after generation has been better and better educated. . . .
>
> If the continuance of the assistance and superintendence, in one form or another, of the Government is necessary for that purpose—and I think I have shown it to be so—we must recommend that continuance, though we may treat it only as a means of preparing the labouring classes for a better, but remote state of things, when that assistance and superintendence shall no longer be necessary.

Senior thought the " remote state of things " would come about " in the latter part of the twentieth century."

Marshall held similar views, but for a different reason. He clearly believed that economic progress would soon raise the whole gamut of incomes above the poverty line and that with it would come moral progress sufficient to ensure a wise expenditure of those incomes. There is a very significant paragraph in his evidence before the Royal Commission on the Aged Poor (1893) :—

> *Question* 10356 : Have you given any consideration or formed any opinions as to the possibility of a universal scheme of pensions ?
>
> Yes, there are two especially that I think have a great deal to be said for them, Mr. Charles Booth's and Mr. Moore Ede's modification of Mr. Charles Booth's. My objections to them are that their educational effect, though a true one, would be indirect ; that they would be expensive ; and that they do not contain, in themselves, the seeds of their own disappearance. I am afraid that, if started, they would tend to become perpetual. *I regard all this problem of poverty as a mere passing evil in the progress of man upwards ; and I should not like any institution started which did not contain in itself the causes which would make it shrivel up, as the causes of poverty itself shrivelled up.* (My italics.)

Now, our first reaction may be that this point of view is completely out of date. But what are the alternatives ? One alternative, which is not far removed in principle from the first, is that the State social services should be confined strictly to the relief of poverty, to assisting those who have temporarily fallen below the poverty line (as currently defined) and bringing

[1] I am indebted to Mr. E. P. Hennock for drawing my attention to this work.

them up to the subsistence level, but nothing more. There would always be a few such people but their numbers would dwindle as the standard of living rose. Marshall thought of the voluntary services, especially the Charity Organization Society, as performing this function. The Webbs thought the State could do it better, for various reasons, political and economic; but even the Fabians would have regarded the social services as a continuing institution which impinged *temporarily* on the lives of the citizens, which gave them help at times of special need. And, of course, the whole emphasis of the Webbs' Minority Report of the Poor Law Commission (1909) was on preventive services which aimed at removing the causes of poverty.

All this has, however, given way to something basically different. Without realizing it, we may be drifting into a system in which everyone becomes permanently dependent on the State for certain basic needs and will inevitably become more and more dependent. Not only are the social services no longer self-liquidating; they are self-propagating.

There are several strands in this development. The first strand was spun by Beveridge, who established the principle that all National Insurance benefits should be paid as of right and universally, irrespective of the needs of the beneficiary. This was an understandable reaction against the means tests required if benefits were paid according to individual need, and against the class distinctions of the pre-war insurance system, which was limited to the lower income groups. But the principle means that even if we could all afford to finance our own periods of illness, unemployment, maternity and old age we should still go on drawing out of the Insurance Fund, if only because we had had to pay so much into it, both in contributions and in taxes. There seems to be no prospect of breaking this system of taking in each other's washing, even though each of us were able, and would much prefer, to do his own.

The second strand is the principle that all benefits, including pensions, should be at subsistence level. This sounds reasonable enough and might be so were it not for a number of complicating factors. One is that pensioners are a growing proportion of the population, so that subsistence level pensions tend to be (though as Mr. Hopkin showed in a recent issue of this REVIEW they need not necessarily be) a growing proportion of the national income. Behind this lies the more subtle complication that as our standard of living rises, the definition of the subsistence level and the poverty line becomes more generous. One suspects that by Rowntree's 1900

standards there is no poverty at all in this country now. This does not mean that Rowntree was then a hard-hearted, cold-blooded young statistician and nothing more. He was just as full of human sympathy and concern for his fellow men as he is now. But he had to take his standards from the economic and social climate of the time.

By the 1950's those standards have become quite unacceptable. We must allow for some conventional necessities, for some luxury spending, for variations in rent and for the fact that, as a recent P.E.P. enquiry shows, people forced to cut their spending because of unemployment will in many cases cut down on food and clothes first and try to keep up private insurance payments, children's pocket money, cigarettes, cinemas and football pools. The latest suggestion is that the poverty line should be drawn, not at that level of income which would cover the cost of the bare necessities for subsistence if it were spent entirely on them, but at that level of income at which *in fact, as shown by budget surveys, people do buy*, amongst other things, the minimum necessaries for subsistence.

This amounts to raising the primary poverty line to the same level as the secondary poverty line. The whole problem has been made worse by inflation and the resulting disparity between minimum wages, assistance payments and insurance pensions, which tend to chase rising prices at different speeds. May it not be that public opinion will never accept a definition of the subsistence level such that there will in fact be nobody below it? More than this: it is not unreasonable to say that the level will rise faster than our standard of living—and the growing political influence of the pensioners will intensify this movement.

The third strand is the growing predominance in the social services of those community services which set out to provide, not minimum standards, but the "best possible" standards, namely health and education. When the Health and Education Acts were framed many of us thought that, with the help of doctors and psychologists, interviews and examinations, we could decide exactly how much of these commodities each person needed, and that this amount would be reasonable in relation to our national income. In fact the borderline between sickness and health and between complete and incomplete education can be drawn wherever we choose; it is limited not by technical but by economic considerations.

We know only too well that we could always spend more money on education if it were available; and there has recently been published a fascinating book by a Cambridge doctor (Ffrangcon Roberts: *The Cost of Health*) which shows that as

a result of the progress of medical science there is no upper limit to the amount we could spend on preventing and alleviating disease, especially of the aged. The wonderful new drugs which we now have enable us to live longer and longer, to enjoy more and more expensive ailments. Shaw's Doctor's Dilemma is truly with us now, it seems, but where he least expected it—in a National Health Service.

The fourth strand is being spun, surprisingly enough, by a group of liberals, whom one would not expect to be advocates of State paternalism. The chief among them are Lady Rhys-Williams, Professor Meade and Mr. Alan Peacock.[1] The alarm of these good people at the growing complexity of the systems by which taxation is levied and social service benefits of all kinds are distributed has led to a passionate desire to tidy up the mess and to introduce a uniformly simple scheme of flat rates of tax and flat rates of basic allowance. The schemes vary in detail, but they all involve the payment by the State of a social dividend or basic allowance to every citizen.

We are not here concerned about the rigidities and anomalies of these schemes or about their effect on incentives. But we must express astonishment that the authors see no danger in perpetuating a system by which a considerable part of the national income is redistributed through the State social services. Although the results, in terms of net income received, may appear to be much the same, there is surely all the difference in the world between a régime in which a few unfortunate people receive occasional and temporary benefits to tide them over their misfortune and one in which a large slice of everybody's income is continually channelled through the State. The absence of any direct links between what the individual puts in and what he takes out, the political situation that must arise when any kind of inequality of distribution is discussed, and the sheer paternalism of it all, suggest a rapid disappearance of that small stream of the national income which does not go through the social service pool, and a move towards the complete State control of all incomes.

The final strand is spun by those who see participation in the social services as " the mark of citizenship." This being so, the emphasis must always be on universality and equality of benefits. It is an attitude which had its roots in war-time experience, and we can best understand it by reading Professor Titmuss' excellent volume in the Official War History *Problems*

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[1] Lady Rhys-Williams: *Something to Look Forward To.* J. E. Meade: *Planning and the Price Mechanism.* A. T. Peacock: *The Economics of National Insurance.*

of Social Policy, but he developed it briefly in a broadcast printed in *The Listener* on February 14th, 1952. Suffice it to say that those who would like to see more community and less individuality among us, and those who would like to see more State control of our affairs, both find acceptable this idea of participation in the social services as the badge of citizenship. To the " benefits as of right irrespective of means " principle of Beveridge, and the administrative simplicity of the food subsidy and the Rhys-Williams basic allowance, is added a philosophy of communal equalitarianism which regards every expansion of the State social services as " progressive " and every limitation as " reactionary."

We may therefore summarize the long-term conflict of policy as follows: On the one hand, we may aim at a system of social services which removes poverty by making everybody poor (or everybody rich, according to how you look at it), by giving no benefits unless they are universal, and by socializing the national income. On the other hand, we may aim at a system of social services which removes poverty by raising those below the poverty line above it, by giving selective benefits to groups of people in need, adopting either a means test or the method of insurance categories, and by looking forward to the day when social services will no longer be necessary because the standard of living of even the lowest income groups is above the poverty line.

We have found that there are powerful forces working towards the former system. It remains to enquire what we should need to do if we wanted to arrest this trend. For those who would regard the self-liquidation of the social services as too extreme an objective, let us put the problem as that of combining social security with individual freedom.

IV

SOCIAL SECURITY AND INDIVIDUAL FREEDOM

The first requirement is full employment without inflation. This is too big a subject to be discussed here, but from the narrow financial point of view only it is quite clear that heavy unemployment on the one hand, and rapidly rising prices on the other, each increase enormously the number of people dependent on the Exchequer for their basic or supplementary incomes.

The next requirement is a more rigid definition of the subsistence level. This is not, as some will indignantly protest, a harsh and callous advocacy of grinding the faces of the poor. Nor does it mean that the poverty line should never be raised. It simply calls for a recognition of the fact that if we want to

cure poverty there must be some standard at which we expect to do so. If our ideas of where the subsistence level should be are always several leaps ahead of our achievements through economic progress and redistribution of incomes, we shall never cure poverty. In that case we should be honest and admit that we are really aiming not at relieving poverty but at removing inequality.

A third requirement is the solution of the means test problem and the extension of the insurance principle. At this point we may usefully take account of the views of two Conservative M.P.s, Mr. Iain Macleod (now Minister of Health) and Mr. J. E. Powell. In *The Social Services—Needs and Means*, a pamphlet published by these gentlemen in 1949, and more particularly in a broadcast talk by Mr. Powell (replying to Professor Titmuss and published in *The Listener* on April 17th, 1952) we have the following argument: The social services should be the means by which the strong help the weak. This being so, the weak must be defined in some way which necessarily implies a test of means. But whereas the old Poor Law applied one general destitution test to every individual applicant, the social legislation of the last forty years separated out different types of social service with different types of means test, some of which operated at subsistence level, some above it. Since the war, inflation has forced increasing numbers of people to seek help from the National Assistance Board; insurance benefits have fallen behind the rise in prices, and one in five is now supplemented by the Assistance Board; Health Service charges have been introduced and those in need can go round the corner after paying them and recover them from the Assistance Board. In this way more and more people are becoming subject to the subsistence means test of the N.A.B. —in other words we are going back to the single destitution test of the Poor Law.

The Conservative pamphlet ends on a very feeble note by saying (*a*) that measures to stabilize the value of money are outside its scope, (*b*) that to tie benefits to the cost-of-living index is " not feasible," (*c*) that insurance contributions must be raised—but not the employer's premium because it enters into the cost of exports, and not the Exchequer premium because it bulks so large in the budget!

Powell's broadcast, however, takes us further along the road of long-term policy. He says there :—

> If we believe in the maintenance of property, then in the social services we should guarantee not a common standard but a minimum standard. Thus benefits should be concentrated where they are needed. We must therefore ascertain need but not necessarily by

> a means test. We must limit the area of need as far as possible and make as large a section of the community self-providing as possible in the basic needs of the individual and the family.

It is difficult to discover what exactly these gentlemen want; but if they are saying that we must identify and assist those in need by some other method than the type of means test administered by the National Assistance Board, they recognize an important social fact. For it is abundantly clear that this type of means test is unpopular, because people resent enquiry into their personal circumstances; and also unsatisfactory, because it is wasteful of skilled manpower and often breaks down over the difficulty of deciding what personal assets and resources should be ignored in the assessment of means.

May it not be that the solution lies, not in a hotch-potch of different types of means test, discriminatory charges and the like, but simply in an extension of the principle of insurance? There is evidence to show that the idea of insurance, social or private, is acceptable to the general public, whereas the idea of charity, public or private, is not. People have got into their heads that insurance benefits are something they can claim quite unashamedly: they have a right to them because they have contributed. They have also got into their heads that "free" benefits are immoral, and confusion is increased by the fact that most people still think the Health Service is financed out of insurance contributions. If we could make national insurance more genuine, in the sense of transferring benefits from the fortunate to the unfortunate, on the Friendly Society pattern, and in the sense of saving up for old age, in the manner of life insurance, and make it less equalitarian, in the sense of being increasingly financed out of general taxation, we might achieve security without means tests and without charity.

A further requirement is the adoption of some logical principles by which people would pay for part at least of the services of health and education. Have we not yet reached the stage envisaged by Senior where most of those who can afford to pay for these services can be trusted to do so? Is it not possible, by a combination of payment for the less costly services and insurance for the more costly, to introduce some relationship between what people pay in and what they take out?—since, as we have shown, there are no "technical" limits to our needs for these services.

Finally, we shall not stop the self-propagation of the social services unless we believe profoundly in the right of people to earn and spend their incomes as they wish. Let us be clear about this. We are not crying *laissez faire* in the sense

of doing nothing to help those in need. We are simply saying that it is better to help them by methods which can be liquidated when they no longer need help than by methods which make them permanently dependent.

POSTSCRIPT

In conclusion, we must consider the latest contributions to the debate, which came to hand after the bulk of this article had been written. The first is a most penetrating essay by Mrs. Barbara Wootton on *The Labour Party and the Social Services* in the *Political Quarterly* for January–March, 1953. Professor Jewkes once said that Mrs. Wootton had the habit of " giving up what would normally be regarded as her queens and bishops in the game, and then proceeding to put up a novel and most prickly defence with her pawns." Here is the paragraph in which, in this essay, she performs the first part of the trick :—

> The financial overhaul, together with all the bits and pieces that go to make improvement in the social services, can be put in hand without much reference to other chapters in the party programme. But anything beyond these brings us up against the fact that a programme is, or should be, the reflection of a philosophy, and that its parts are inter-dependent in terms of that philosophy. The social services, being hearty spenders of public money, must take their place in a list of priorities. Till that place is known, no intelligent planning is possible. It hardly needs to be said that everything depends upon the general economic situation, upon the degree of priority assigned to rearmament, and upon the size of the hole which military expenditure continues to make in the budget. The direct impact of these issues upon social service policy appears in terms of money : but the figures of course are merely the outward and visible sign of political and, indeed, moral judgements.
>
> Certainly the future design of the social services waits upon some clearer decision as to what these services are supposed to be for. In particular, are they intended to contribute to a policy of social equality ? Or are they just part of the national minimum programme enunciated in the earlier work of the Webbs—measures to secure that nobody starves, or is too poor to see a doctor, or lacks a rudimentary education ? It is the answers to these questions which must govern the whole future of our social services.

The pawns, however, are very prickly ; for, in setting out the various tasks that await the next Labour Government, Mrs. Wootton quite clearly assumes that social equality and State control are the over-riding criteria.

First, there must be an administrative overhaul which will make the social services as good in practice as they sound in theory. The whole structure suffers, she says, from " elephantiasis." It is too big, but she will not allow any modifications that would make it smaller—any move in Mr. Powell's direction

of " making as large a section of the community self-providing as possible." The elephant must remain, but its keeper must make it run; and so it all comes down to hoping and praying for a super-Minister " with fire in his belly " who will solve all the problems.

Then, we must have a financial overhaul to replace the present " complicated " and " inequitable " system by one that is simpler and more uniform. She admits, with characteristic candour, all the defects of the existing National Insurance scheme, and comes very near to suggesting that adequate benefits *for those who need them* should be provided out of general taxation. But no; the benefits, whether adequate or not, must be universal; so she plunges for a modified form of the Rhys-Williams scheme (after deploring the fact that it has already been adopted by the Liberals).

Similar sacrifices on the altar of equality are made on every page of the Labour Party's statement of policy, *Challenge to Britain*, issued as this article goes to press. In this case, however, there is not even Mrs. Wootton's frank recognition of a long-term choice between the use of selective services to relieve those in need and the provision of equal and universal benefits irrespective of need.

The first stage in this programme is the establishment of standard, free services for all: more comprehensive schools, State scholarships for every accepted student, national insurance benefits tied to the cost of living, health services without any charges, and the bringing of basic foodstuffs " within the reach of all by subsidies and other methods." There is frequent insistence on the *best* standards, of course, but the principle remains that everything must be free and equal—except the progressive taxation out of which it is all financed.

Then comes the " taking over " of the public schools, State control of University teaching, a " special examination " of all private insurance and superannuation schemes, and so on. In no part of this enormous field must there be any prices, in no part must people be allowed to decide how much of their incomes to spend on these goods and services.

Is this really what we mean by social security? As we said earlier, the relief of poverty and the pursuit of equality are not the same thing.

WALTER HAGENBUCH.

Queens' College,
Cambridge.
June, 1953.

Policies and Operations of the World Bank

By Eugene R. Black

President, International Bank for Reconstruction and Development

THE International Bank for Reconstruction and Development, often called the World Bank, is the first bank specifically set up to encourage capital investment on a world scale. Its constitution, in the form of Articles of Agreement, was written at a 44-nation conference held at Bretton Woods, in the United States, during the summer of 1944. The Articles reflected the expectation—now only too well confirmed—that there would be no full and spontaneous revival of international investment at the end of the war. They were based on the hope that a soundly organized intergovernmental institution, working in co-operation with private capital, could help find the funds that would be needed to reconstruct countries damaged by war and to promote economic growth in countries as yet under-developed.

The Bank is made up of member governments—54 in all—and only governments may belong. On joining, each government subscribes to shares in the Bank's capital, the amount of the subscription in each case depending on the member's national income and international trade. The U.S.S.R. and her satellites (apart from Czechoslovakia), the Argentine, Spain, Portugal, Switzerland and New Zealand are not members.

All the powers of the Bank are vested in its Board of Governors, consisting of one governor from each member country. The Board normally meets only once a year and it has delegated its powers in respect to the general operations of the Bank to the executive directors. There are sixteen executive directors; each represents a country or group of countries, and each votes in proportion to the shares held by his constituents. The executive directors select the president of the Bank who is chairman, *ex officio*, of the executive directors and is chief of the operating staff of the Bank. Members of the staff, recruited from some 30 countries, owe their duty entirely to the Bank.

The subscribed share capital of the Bank is $9,036 millions (roughly £3,200 millions). Only 20 per cent. is, however, paid up and the remaining 80 per cent. can be called up only if

needed to enable the Bank to meet its liabilities. Of the paid up capital equivalent to $1,804 millions, $177 millions (2 per cent. of the nominal amount) has been paid up in gold or dollars. The remaining $1,627 millions (18 per cent. of the nominal amount) has been paid up in the currencies of the member countries, and really represents a fund of 54 different currencies.

These 54 currencies can be used only with the approval of the member concerned. The United States has approved the use of the whole of the 18 per cent. part of her subscription: this gave the Bank the use of $572 millions. The United Kingdom, the second largest shareholder in the Bank, has paid in about £83·6 millions as the 18 per cent. part of her subscription. By the end of 1952, some £4 millions of this had been released for lending. Early in February, the government announced that it aims to make £60 millions sterling available for lending by the Bank to Commonwealth countries in the sterling area over the next six years. With these releases, and with others the Bank hopes to obtain outside this arrangement, the greater part of the United Kingdom's paid up subscription will become available for lending. Other shareholders have released varying amounts, and the total available for lending (including the 2 per cent. paid up in gold or dollars) is equivalent to over $1,150 millions (about £400 millions). The Bank is finding more and more that its members are prepared to approve the use of amounts they have paid in.

It was intended from the outset that the Bank's capital from governmental subscriptions would be augmented by private loan capital. As early as 1947 the Bank entered the New York market with two issues totalling $250 millions—$150 millions in 3 per cent. twenty-five-year bonds and $100 millions in 2¼ per cent. ten-year bonds. In the following year an issue was made of 17 million Swiss francs of short-term 2½ per cent. serial bonds. Since then there have been various issues in New York and Switzerland. In London an issue of £5 millions of 3½ per cent. twenty-year stock was made in 1951. The Canadian market was entered in 1952 with an issue of Can. $15 millions in 4 per cent. ten-year bonds. Altogether the Bank has raised the equivalent of U.S. $570 millions, of which $15 millions has been repaid. Just as the use of the 18 per cent. portion of the members' capital subscription requires their approval, so their approval is required before the Bank can make issues of capital in their markets. The reason is the same in both cases: it is to protect the member from having

to make an export of capital which his economic position does not warrant.

The Bank began operations officially in June, 1946, and it made its first loan in May, 1947. By the end of 1952, it had made loans for about 250 projects, large and small, in 26 member countries, involving a dozen different currencies. It has given its members guidance on their development plans and helped in the training of their technicians.

STIMULATING INVESTMENT

Nothing like the Bank existed before. Working from its constitution and moving from one precedent to another, it has built up a code of policies and practices to guide its day-to-day activities. This code, be it added, has not been reduced to writing or formulated in any systematic way, and it is constantly being modified as new situations arise. The Bank is a relatively new organization and it is constantly learning as it goes. It is, however, worth while, at this early stage, to step back for a moment from the preoccupations of current business and review the Bank's operational principles and methods as they have been evolved in the past six years.

The main purpose of the Bank, as described in its Articles of Agreement, may be summarized under three headings. They are, first, to facilitate the investment of capital for productive purposes; secondly, to promote private foreign investment, by means of guarantees or of participations in loans by private investors; and thirdly, to make loans when private capital is not available on reasonable terms. The emphasis in the Bank's constitution is not on what the Bank itself can lend, but on ways in which it can stimulate the growth of investment nationally and internationally.

It may be well, then, to start by saying something about the ways in which the Bank tries to help its member countries make the best use of the resources they themselves can command. An important means the Bank has used has been the general survey mission. This usually consists of a group of experts brought together to make an intensive, first-hand study of a country's resources and to formulate the basis for a long-range development plan. These groups have varied in size and composition according to the individual needs of the countries to be visited. Usually they have included advisers on public finance and general economics, industry, electric power, transport, agriculture, education and public health. Some of these specialists come from the Bank's staff. Others

are recruited from other international organizations, member governments and from private life.

The Bank has organized ten survey missions: seven for the Western Hemisphere countries of Colombia, Guatemala, Cuba, Nicaragua, Surinam, Jamaica and British Guiana; two in Asia—Iraq and Ceylon; and one in Europe—Turkey. A preliminary mission to Nigeria is being organized.

The report submitted by a general survey mission provides at best only a start. Economic development is a difficult and complex process. Moreover, it is a process essentially dependent on domestic attitudes and domestic action. Outside advice can help by sharing experience and technical knowledge, but the main burden still falls on the government and the people of the individual country. Indeed, probably the chief contribution a survey mission can make is the stimulus it may give to the adoption of realistic goals and of a practical programme for achieving them. The missions have warned against over-ambitious undertakings, and consistently have urged attention to fundamental tasks such as improving administrative efficiency, raising the level of technical education and bringing the results of scientific research within the grasp of the small farmer, artisan or manufacturer. Although spectacular results are unlikely, the survey missions encourage a long-range, objective approach that should contribute usefully to efforts toward increasing productivity and raising standards of living.

LENDING POLICY: FIVE CRITERIA

Let us now turn from precept to practice and see how, in its own lending, the Bank participates in the process of international investment. Its Articles of Agreement lay down a number of conditions which have to be satisfied before a loan can be made. A discussion of five of these conditions will bring out the main criteria which the Bank applies in its lending.

The first is that the borrower is unable without the intervention of the Bank to obtain the money needed under reasonable conditions (Article III, Section 5 (ii)). The Bank does not compete with private investors. If a borrower can obtain money from private sources, the Bank cannot intervene, and indeed would not wish to do so.

Obviously, the Bank must also take into account what is being done by other public agencies, as it did when the Marshall Plan came into effect early in 1948. In the summer of

1947, the Bank had made loans to France, the Netherlands, Luxembourg and Denmark to enable them to buy badly-needed equipment and commodities from the dollar area, and thus had helped to keep them going during a critical period. Then the United States stepped in to make dollars available under the European Recovery Programme. The funds of the U.S. Economic Co-operation Administration were much larger than those the Bank had available at that time, and were mostly given as grants. Further Bank lending for general reconstruction would merely have reduced the amount of assistance which the borrowing countries could get from ECA. The Bank therefore felt that for the duration of the Marshall Plan its work should lie mainly outside Western Europe.

As time went on, however, the European Recovery Programme changed from an emergency plan to prevent a breakdown to a longer-range programme for developing the resources of Western European countries and their overseas dependencies. The Bank and the United States Government then built up a working relationship based on the principle that they would exchange pertinent information on operations within the same area. This applies to the operations of the Export-Import Bank of Washington, an agency of the United States Government, as well as to the ECA and its successor, the Mutual Security Administration.

It has been possible, on occasion, for these agencies and the Bank to engage in operations which have been complementary. In Iceland, for example, the development of hydro-electric power and the erection of a fertilizer plant are being carried out with funds provided partly by loans from the Bank, which has lent several European currencies to enable purchases to be made in Western Europe, and partly with dollars provided by MSA for the purchase of materials and equipment from the dollar area. In Africa, to take another example, the Bank is lending money to help Rhodesia Railways build their half of a new railway line from Southern Rhodesia to the coast; while the other half, in Portuguese East Africa, is being financed with the help of a loan from the Export-Import Bank.

The second condition which has to be satisfied, and one closely allied to the first, is that proper efforts have been made to raise capital in the member country. The task of mobilizing local capital, needless to say, is a difficult one in under-developed countries. The savings they can put into investment usually represent a smaller proportion of their

very much smaller *per capita* income than in the more highly developed countries.

Even where average *per capita* income is low, however, it is still important to increase savings. If the wage-earner or cultivator cannot be expected to save, there may be income of the merchant or land-owning classes which can be channelled into productive fields. The Bank helps this process whenever possible. The measures we discuss with potential borrowers cover a wide range. They include budgetary and fiscal policies, and legislation to facilitate the growth of a capital market. In 1949, we participated in discussions which led to the establishment of a privately owned industrial development bank in Turkey. In El Salvador we helped float a governmental bond issue early in 1950 to cover part of the cost of a hydro-electric power station on the Lempa River. In 1951, the Bank's treasurer went to Iceland to advise the government on setting up an industrial development bank. In 1952, we sent a consultant to Colombia to prepare a report on measures needed to stimulate private investment. Other examples could be cited.

REPAYMENT PROSPECTS

The third condition is to meet the requirement in the Articles of Agreement that, in lending, the Bank shall act prudently and pay due regard to the prospects that the borrower and guarantor will be in a position to meet their obligations (Article III, Section 4 (v)). Even apart from any statutory provision of this sort, the Bank would have been bound to place great emphasis on prospects of repayment. The Bank's paid up share capital is relatively small. It was always envisaged that the Bank, to carry out its functions, would depend largely on its ability to borrow in the open market or to aid others to do so by giving its guarantee. To be sure, the holders of the Bank's obligations are protected by its constitutional authority to call on its members for proportionate shares of their unpaid capital, should those funds ever be needed to meet the Bank's obligations. Yet the Bank obviously can have the full confidence of the market only if it follows the policy of making loans which it is satisfied will be repaid. Otherwise, even though the investment would be protected by unpaid capital (80 per cent.) the Bank cannot expect private investors to lend it money or accept its guarantee.

Repayment prospects have two aspects: First, will the borrower have enough cash in his own currency to cover the payment of interest and capital? Secondly, will the country

be able to provide foreign exchange to enable that currency to be transferred? If the project to be financed has been set up on a proper basis, sufficient cash to service the loan should be assured. Since, in any case, the government of the country is the guarantor, if not the actual borrower, and since governments can usually contrive to find enough of their own currency to meet their obligations, this aspect of the problem, while important, is secondary to the problem of providing foreign exchange.

The main consideration, then, in assessing repayment prospects, is the willingness and ability of the country concerned to follow economic policies which will enable it to earn enough foreign exchange to pay its debts. Of major importance is the "will to pay." If that is lacking, a country in a strong economic position may fritter away its resources and leave its creditors in the lurch when conditions change for the worse. If the will to pay is there, heavy sacrifices will be accepted in order to maintain a good credit standing. To be sure, events have sometimes made defaults inevitable, and an unblemished debt record is not a *sine qua non*. If defaults have occurred, however, the attitude of the debtor to his obligations and the sort of settlement he has made with his creditors are valuable pointers in judging his credit for future loans. Of the economic factors to be taken into account, the most important factor is the country's international balance of payments position and prospects. Here it is the trend rather than the present position which is important. A developing country frequently has a deficit on its current balance of payments because it is importing capital. This does not necessarily mean that the Bank could not lend to that country. The test is whether the country, as a result of its general economic policies and of the investment capital which the Bank is helping to create, is moving to a position in which it will be able to balance its international accounts without undue strain.

If all currencies were freely convertible, the Bank would have to consider only the total balance of payments of the country concerned. In the absence of convertibility, however, the balance of payments in the currencies lent is relevant. For example, a country may conduct a great deal of its trade in sterling and have a favourable balance of payments in sterling, but may have poor prospects of earning a balance of payments surplus in dollars. Here again it is the prospective situation rather than the present one which is the more important.

Those who framed the Articles of Agreement considered that loans by the Bank normally would be in foreign exchange required for the import of equipment destined for particular projects. And they were not far wrong, for up to now nearly all the loans made by the Bank have been of this kind. It was realized, however, that this simple rule would not fit all situations. The Articles of Agreement, without being specific, provide that the Bank may depart from it "in exceptional circumstances."

The Bank has taken the position that it is willing to make loans to meet the *indirect* foreign-exchange requirements arising from development projects of exceptional importance. Several loans of this kind have been made. Perhaps the clearest example is the $10 millions loan made in 1951 to the *Cassa per il Mezzogiorno* in support of that agency's programme for the development of southern Italy. It was anticipated that the large local expenditures under the plan would raise the general level of employment and business activity, and that this, in turn, would cause an increased demand for imported goods and foreign exchange. The Bank's loan was intended to meet this indirect effect of the development plan on Italy's dollar position during the first year or so of the Cassa's activity.

The question has sometimes been discussed of what sort of "exceptional circumstances" might justify the Bank in making loans which would not finance imports at all, but would provide local currency for local expenditure. So far the Bank has not been presented with a proposal for which a loan of this kind seemed to be justified.

The Bank has been flexible in its interpretation of what constitutes a "specific project." In each of the four reconstruction loans made in Europe, the "specific project" was a broad programme of reconstruction whose execution needed imported equipment. The two loans to Australia are basically of this type, although they are more "specific" than the earlier European reconstruction loans. In these six loans the Bank financed specific items of equipment imported, for the most part, from the United States. A further development of the programme loan became necessary when the Bank was asked to help finance a development programme using largely local labour and equipment (as in the case of the Italian plan for southern Italy) or local labour and equipment imported from the mother country (as in the case of the ten-year plan for the Belgian Congo). In these cases the Bank financed a

proportion of a much larger plan, without attempting to relate its loans to specific imports.

The Bank is prohibited from making "tied" loans (Article III, Section 5 (a)) and in fact encourages borrowers to invite international bids or to "shop around" for the most advantageous terms. Thus if the borrower wishes to buy some equipment in the United Kingdom, the Bank will provide him with sterling; if the purchase is to be made in France, he will get francs. The currency in which the loan is expressed in the loan contract is not necessarily that which the borrower receives. Indeed, in some cases, especially when international bids have been called for, the borrower cannot be sure when he signs the loan contract where he will make his purchases, although he may have a general idea of where the goods are likely to come from.

The Bank may obtain the currencies needed by a borrower in one of two ways: by using some of the currency which it has available for lending or by purchasing it with another currency. The loan will be repayable in the first case in the currency actually received by the borrower; in the second case the loan will be repayable in the currency used to make the purchase.

The greater the variety of currencies available to the Bank for lending, and the more freely they can be converted into one another, the greater is the ease with which the Bank can adapt its loans to meet individual needs. Our two most recent loans to Yugoslavia, for example, although they consist entirely of European currencies, went in part to finance purchases in the United States. Since, however, it was considered that Yugoslavia could repay Swiss francs more easily than dollars, and the Bank had Swiss francs which it could use for acquiring dollars, the Bank is actually making parts of the loans in Swiss francs.

SELECTION OF PROJECTS

The fourth condition is that a loan from the Bank, taken in conjunction with the investment financed in other ways, would result in the more useful and urgent projects being dealt with first (Article I (ii)). The only practicable way of applying this test is to look at the investment pattern of the country in which the project is situated. The total amount of capital investment in any country is usually made up of a variety of elements. It will probably include projects, such as housing, transport, and power supply, which because of their

size and character are carried out by public authorities and have to be planned a long way ahead. It will include new plants and plant extensions carried out by industrial concerns, large and small. It will include farm improvements and the construction of houses and shops for private ownership. Whether or not all these projects will be carried out will depend on the economic climate, which may change from year to year. In such an economy, the term "programme" may be misleading, as it may refer to little more than a reasonable expectation of the amount of investment which will be carried on and the probable direction of it. Experience has shown, however, in spite of all the reservations that have to be made, that it is useful for a government to consider the general direction and trend of the nation's investment. In more than one instance, insistence by the Bank on this approach has forced a government to consider for the first time whether the main lines of the country's development were sound.

One advantage of drawing up an investment programme is that it may reveal that a country is trying to go ahead too fast. In other words, too much investment may be proposed, having regard to the resources which are likely to be available. The result, as has been seen so often in recent years, is likely to be the generation of inflationary pressures, weakening the will to save, and leading to the misdirection of resources in the over-expansion of some industries, and the neglect of others.

Even after looking at the main lines on which a country is being developed it is not always easy to say what projects are the "more useful and urgent." They must, of course, be "productive," that is, they must directly or indirectly increase the output of goods or services. But since most projects would pass this test, more searching tests have to be applied. The most obvious test is whether the project will pay in the ordinary commercial sense of providing an adequate return on the capital invested in it. Failure to meet this requirement does not necessarily make the project ineligible. An irrigation or flood control scheme, for example, may bring great benefits to the country as a whole without yielding to the authority responsible for its operation an adequate return on the capital invested in it. Another test is the effect of the project, when it is completed, on the country's balance of payments. Sometimes, it will be possible to estimate directly the increase in export earnings or reduction in import costs which will result

from the project. For example, the aircraft financed by the Bank for KLM Royal Dutch Airlines will bring an ascertainable benefit to the balance of payments of the Netherlands. In other cases the benefit will be indirect. A programme of highway construction and rehabilitation in Colombia or railway improvement in South Africa, for example, while they are urgently needed and will bring great benefits, have an impact on the balance of payments which is indirect and impossible to measure precisely.

The fifth condition is that the borrower must be equipped technically, financially and administratively, to carry out the project. More than once, the Bank has been asked to finance projects which, even after a quick examination, can be seen to be totally beyond the manpower, the money and technical ability available. This is one of the reasons why, before financing any particular project, the Bank insists upon the study by technicians—engineers, economists or businessmen with special knowledge of the industry concerned—of projects submitted to it for financing. At first there was a tendency for borrowers to regard this as an unwarranted intrusion into their affairs. There is now, however, a greater understanding of the advantages that discussion with experienced and impartial technicians may bring, and the Bank sometimes has been able to make suggestions for the better planning and execution of the projects it is financing. It may perhaps be added that the Bank's interest in the project is maintained throughout the construction period, and even beyond, and it is the Bank's practice to send its representatives from time to time to make on-the-spot examinations and to report progress.

OPERATIONS TO DATE

These, then, are the criteria which the Bank applies, and we can now turn to review briefly the results of their application. The founders of the Bank, meeting during the war, naturally placed reconstruction before development in the Bank's title and in its purposes. In practice, it is difficult to draw a clear line. The erection of a chemical pulp plant in Finland to replace plants lost when territory was ceded to the U.S.S.R. may be called reconstruction, although it was financed out of a loan for the development of wood products industries; on the other hand, the purchase of modern electric gantry cranes by France for port rehabilitation has a development as well as a reconstruction element in it. The Bank has adopted a " rule of thumb " of calling its first four loans to Western Europe

reconstruction loans and has regarded everything that came after as development.

The Bank has not attempted to allocate its resources among its members or to assess priorities among them. The assessment of the relative priority of different projects within a single country is difficult enough; to assess the relative importance of an irrigation scheme in Australia and an electric power plant in Mexico is obviously impractical. Fortunately, the problem has never arisen in practice, for the main criteria for Bank lending have been the five described above. So long as the Bank has sufficient funds to finance projects meeting these conditions, no problem arises of allocating funds or determining priorities between members.

Apart from the \$497 millions of reconstruction loans made in 1947 to France, the Netherlands, Denmark and Luxembourg, the loans made by the Bank by the end of 1952 totalled the equivalent of about \$1,000 millions. Nearly two-fifths of this amount, viz. \$395 millions, was lent for electric power development, mostly in the Western Hemisphere. About a fifth of the total, some \$213 millions, was for transport; most of this has been for railways in Asia, the Middle East and Africa, although the Bank has also financed highway programmes, port and harbour development, and the acquisition of merchant shipping and aircraft. The next largest field of lending was agriculture and forestry, for which \$147 millions was lent, with industry (\$125 millions) and general development (\$92 millions) accounting for the rest.

How is it the Bank has so often found that the "more useful and urgent" projects have been public utilities? The main reason is that without basic services such as transport, electric power and telecommunications, economic progress is impossible. On more than one occasion, even in countries which are far from being "under-developed," it has been found that economic advance was being hampered by lack of rolling stock, out of date ports or shortage of electricity. A good example is Australia, where after the war basic services lagged behind industrial expansion. Other examples are the Union of South Africa and the Rhodesias. It remains to explain why basic services have lagged rather than been in the van. Conditions differ so much from one country to another that it is impossible to generalize. In most countries, however, utilities require heavy capital expenditure and in the best circumstances yield a return over a long period. In many countries, moreover, these services are quasi-monopolies subject

to public regulation and susceptible to popular pressure, and are unable for political reasons to earn an adequate return on their invested capital. They therefore frequently fail to attract private investment on the scale required. In other countries the basic services have been State-owned and have been held back because the government did not want to undertake heavy public expenditure at a time when private investment was making large claims on the economy.

Borrowers from the Bank have been mostly governments and public corporations. One reason is that the " more useful and urgent " projects which the Bank finances, as we have just seen, are frequently public utilities, which in most countries are run by the government or by the public authorities. A second reason rises from the requirement in the Bank's constitution that loans to private borrowers have a governmental guarantee. Private companies are sometimes reluctant to ask for government guarantees and governments are sometimes reluctant to give them. These feelings are understandable. If a government gives a guarantee to a private company, it opens itself to the charge of favouring that company over its competitors and, what is often more important politically, over public projects. Private enterprise, on its side, may hesitate to ask for a government guarantee because of fears that this may lead to demands for government participation, interference or control. To what extent these fears are justified, it is unnecessary to say. The fact is that they exist.

Loans made up to the end of 1952 amounted to the equivalent of some $1,524 millions. Loans made directly to private enterprises in the strict sense of the word accounted for only $178 millions. This figure includes $90 millions lent to the Brazilian Traction, Light and Power Company, $26 millions to the Mexican Light and Power Company, $12 millions to four shipping companies in the Netherlands and $31·5 millions for the Indian Iron and Steel Company. The remaining $1,345 millions have been lent either to governments ($816 millions) or to public authorities and public corporations ($529 millions). Little significance can be attached to the division between government and public authorities: in many cases the decision on who the borrower shall be is based more on administrative convenience than anything else.

The figure of $178 millions for loans made direct to private enterprise, however, greatly understates the amount of assistance given to the private sector of the economy. Many of the loans made to governments or public bodies have in

fact been used to help privately owned companies. In some cases, the proceeds have been re-lent to industry; that was true, for instance, of the loan made to the Bank of Finland in 1949, which benefited electric power companies and firms making wood products. In other cases, the Bank's loans have provided foreign exchange which then has been purchased by private industry with local currency. A large part of the proceeds of the reconstruction loans was distributed in this way, and the same is true in the more recent examples of the Bank's loans to Australia in 1950 and 1952.

Loans made by the Bank, except to member governments themselves, have to be guaranteed by the member or by its central bank or comparable agency. Thus far, the Bank has always taken the guarantee of the member government. The conferees at Bretton Woods thought that much of the Bank's business would consist of applying its own guarantee to loans raised in the private market; but there have been only one or two proposals that the Bank use its guarantee, and these in cases which were clearly not suitable. The use of the guarantee for dollar loans is further hampered by the fact that this type of operation is not familiar either to New York banks and issuing houses or to American investors. The Bank, however, has brought its guarantee powers into play in some of its arrangements for the participation of private finance in its loans. The first operation of this sort was carried out in July, 1948, when the Bank made four loans totalling $12 millions to Dutch shipping companies and immediately sold a large part of them to a group of New York banks. Less than a year later the Bank made a loan of $16 millions to Belgium and quickly sold the entire issue to a New York group. At the end of 1952, the Bank had sold with its guarantee some $45 millions of obligations received from borrowers, and, in addition, had sold $21 millions without recourse.

Most of the loans made by the Bank have been denominated in dollars. The currency in which the amount of the loans is expressed is, however, more a legal technicality than an indication of the currencies which are actually provided and in which the loan will have to be repaid. All but three loans have been denominated in dollars, or their equivalent, and it is true that because loans have been to borrowers a "hard currency" (one that they wanted) and to the Bank a "soft currency" (one which was available) most of the disbursements have been made in dollars. The use of other currencies, however, is increasing. During the fiscal year ending June 30th,

1952, about one-sixth of the funds committed in new loans were in currencies other than dollars; during the first three quarters of the fiscal year now drawing to a close, the proportion was about one-fifth.

INTEREST RATE POLICY

The Bank's Articles of Agreement do not lay down any policy to be followed by the Bank in fixing the interest rates on its loans, although it is implied that they should be high enough to enable the Bank to earn a profit. In making its first loans, therefore, the Bank had to decide what its interest rate policy should be. Any direct relationship to what the borrower would have to pay in the market was, in the circumstances of the immediate post-war years, out of the question. One reason was that in some cases borrowers would not be able to raise money abroad at all. In others, the rates would have been so high as to be prohibitive. A third reason might perhaps be added: the application of different rates to different borrowers would have been regarded as contrary to the concept of co-operation on which the Bank was founded.

Instead, somewhat the following reasoning was adopted. The Bank would have to borrow in order to be able to lend. Its lending rates should, therefore, be based in the first place on what it has to pay for borrowed money. Secondly, the Bank, like any other lending institution, would have to build up reserves for bad times. The Articles of Agreement provide that during the first ten years of its operation it should charge a special commission of not less than 1 per cent. per annum on the amount of its loans, this commission being put in a special reserve to meet obligations arising out of its borrowing or guaranteeing operations. The rates of interest charged by the Bank have therefore been computed by taking the rate at which the Bank could in theory borrow (the yield on its own securities) and adding 1 per cent. for the special reserve and about $\frac{1}{4}$ of 1 per cent. for administrative expenses. Thus far, borrowing operations have been predominantly in dollars; the theoretical cost of borrowing in New York has therefore been used, even where it was known that the loan would be disbursed out of funds borrowed elsewhere at higher rates.

The general reconstruction loans made in 1947 carried interest at $4\frac{1}{4}$ per cent. The rate on long-term loans in 1948 was $4\frac{1}{2}$ per cent., which reflected the somewhat higher cost of borrowing. With a trend towards lower rates in the United States, the Bank's rate then fell gradually, until in 1950 it was

4 per cent. From 1951 onwards, there was a general hardening of money rates and the Bank raised its rates accordingly. The most recent long-term loans have been at $4\frac{7}{8}$ per cent.

CONCLUSION

Measured against the total of international investment, the Bank's lending can never be more than marginal. But even within this limit, much can be done. The Bank sees its main task as that of encouraging the flow of private capital from countries where it is relatively plentiful to countries where capital is relatively scarce. Great encouragement, of course, would be provided by the existence of conditions in recipient countries which would give foreign capital a friendly environment in which to play its proper part.

The Bank's main influence must naturally be in the economic field. At the moment, perhaps the greatest service we can render is to convince ambitious countries that sound, non-inflationary policies provide the only firm basis for progress. We have also worked with some success to convince our members that scrupulous adherence to their monetary obligations—internal as well as external—provides the only climate in which private investors will be willing to send their money abroad.

Finally, the Bank can continue the work it has started of helping to finance projects which themselves provide the key to further development. There may be new techniques to be tried. Guarantees by the Bank of privately arranged loans may be possible. The Bank stands ready to consider any activity which seems likely to enable it better to fulfil its basic purpose of facilitating the productive investment of capital.

EUGENE R. BLACK.

International Bank for Reconstruction and Development, Washington.

April, 1953.

Trends in Public Finance

By R. C. Tress

THE last twelve months have seen the close of a chapter in the story of modern public finance, a chapter in that section of the subject headed "Budgetary Policy" or, more flamboyantly, "Functional Finance." We have not, of course, seen the last of the policies which look to the Budget as a prime means of controlling the course of a national economy. Far from it. But, for Western Europe, in the last twelve months, the problem and the method conceived for dealing with it have alike lost their simplicity, while in North America, upon whose buoyancy so much in Western Europe depends, the outlook has acquired a greater uncertainty. The moment is opportune for stock-taking, and the Research and Planning Division of the Economic Commission for Europe, by a number of recent studies, has provided us with a welcome supply of material for the purpose.[1]

Before proceeding to this and kindred material, however, one general point must be emphasized. In any discussion of recent public finance, we must avoid the error familiar to statisticians of exaggerating our picture of changes by foreshortening the scale and omitting the base-line. The more temporary aspects of public finance policy are surrounded by permanent and universal themes. From at least the time of the Romans, governments of all types have been raising and equipping military forces, undertaking large and costly capital works and courting the approval of the populace with gifts of bread and circuses. And, for that same length of time, they have been harassed by the problem of raising enough revenue to support their expenditures. The result is, in each case, a complicated machine, heavy with its past history.

In writing of modern budgetary policy it is reasonable enough, in the first instance, to treat government expenditure and revenue as composed of a few simple categories. The most important distinction within government expenditure is between a direct government claim on real resources and a transfer, which, though engineered by government, is from one private purse to another. Similarly, the collection of government revenue must, for the most part, turn either upon

[1] *Economic Bulletin for Europe*, Vol. 2, No. 3 (1951), and Vol. 4, No. 2 (1952); *Economic Survey of Europe since the War* (1953).

the ownership of capital or on the receipt—or expenditure—of income.

There are times when such a simple treatment is adequate to the problem in hand; but not always, and probably not now. In the United Kingdom, to take only the most familiar example, the itemized estimates of the central government's expenditure fill many annual volumes and to these some record of the activities of the local authorities, the national insurance funds and possibly the public corporations must be added. Likewise, although three-quarters of the public revenues are raised from just seven sources—the income tax, estate duty, purchase tax, the taxes on drink and tobacco, local rates and national insurance contributions—a score of other devices remain, ranging from customs duties whose origin is in trade protection to stamp duties, betting taxes and licences for dogs. And our Chancellor of the Exchequer finds himself able to forgo entertainment duty on first-class cricket but cannot afford the same concession to third-division football. The engine of public finance, though it works surprisingly well, has probably more affinities with the productions of Mr. Emmet than with those of Sir Frank Whittle.

I

TAXABLE CAPACITY

Any public finance policy, and particularly a policy which demands flexibility in government expenditure and revenue, must first solve the problem of taxable capacity. The fundamental determinant of taxable capacity is, of course, the wealth of the country concerned. Of real resources, the State cannot extract more than the total national product; for such purposes as defence, administration and capital investment, the State cannot take more than is left after the minimum consumption needs of the people have been met. But as far as the raising of tax revenue is concerned, these are not the real limiting factors. Though bounded by the size of the national income and the purposes of government expenditure, the effective limits to taxable capacity are set most immediately by such factors as the quality of public administration and the education and political sense of those called upon to pay the taxes; to these, in the case of federal systems of government, must be added the complication of constitutional restrictions.

Thus, the tax of most proven effectiveness as a raiser of revenue is the income tax: a direct tax, at a progressive rate,

on assessed personal incomes. But it is essentially the weapon for a sophisticated and politically stable society. As a raiser of revenue, it is superior to the poll tax or the charge on the possession of land only where the development of industry and trade produce annually a large amount of income from sources other than the ownership and working of land, and where the distribution of income is a more complicated affair than the simple division between landed rich and peasant or landless poor. Even then, it is only operable where there are persons able and willing to keep books and make returns and, further, where there is a reliable body of tax administrators to make the assessment and tax collection—where, in other words, there are efficient and incorruptible officials and a literate and law-abiding public. A colonial administration like that of Nigeria, for example, may collect income tax from government servants and the salaried employees of the large trading companies, but to establish an unchallengeable estimate of the profits of bookless and hard-bargaining merchants can be as difficult as counting the herds of nomadic tribesmen. In India, incomes from agriculture are taxed separately from other incomes and make a negligible contribution to revenue. Revenue from other income sources—business shareholders and some 600,000 persons in a population of 300 millions—provides more than one-quarter of all Union and State receipts. Even so, the yield could be greater but for deliberate evasion.

One can find like difficulties in Western Europe. Deliberate tax evasion is a serious problem in France, where a progressive personal income tax was introduced at the end of 1948. While the incomes of wage and salary earners are reported to the authorities by their employers, the self-employed and professional classes make their own declarations and their wilful understatements are notorious. The resulting inequality in the distribution of the tax burden, and the reactions it provokes, are important factors in France's inflationary tendencies.

Belgium, Italy and Spain, on the other hand, have yet to tap the revenue resources which the progressive income tax provides. They are still at the stage of pre-1948 France. They continue to operate a "schedular" tax system, wherein different but unprogressive rates are applied to each of a number of scheduled sources of income. A progressive charge on each person's total income provides no more than a "complementary" addition. Spain, in fact, has the most primitive taxation system of all Western European countries, relying heavily upon miscellaneous excises, death duties and the

revenue from petrol tax. The general point is that, in spite of the fact that all taxes (with the possible exception of high death duties) are paid out of income, and despite the patent efficiency of the personal income tax as a raiser of revenue, personal income taxes in 1948 did not provide as much as half of the revenue of the public authorities in any of the countries listed in Table I. In only seven of these dozen countries was the income tax even the largest single source of revenue.

TABLE I

PRINCIPAL SOURCES OF TAX REVENUE, 1949

Country	Taxes yielding 20 per cent. or more of tax revenue	Taxes yielding less than 20 per cent. but not less than 15 per cent. of tax revenue	Taxes yielding less than 15 per cent. but not less than 10 per cent. of tax revenue
Belgium	Schedular taxes Turnover taxes		
Denmark	Income tax		Tobacco tax Alcohol taxes
France	Turnover taxes ([1])		Schedular tax Income tax
West Germany ..	Income tax Turnover taxes		Tobacco tax
Italy	Turnover tax	Tobacco tax	
Netherlands ..	Income tax	Turnover taxes	Alcohol taxes
Norway	Income tax	Turnover taxes	Alcohol taxes
Spain[2]	Schedular taxes	Miscellaneous taxes on consumption goods Death duties	
Sweden	Income tax		Alcohol taxes
United Kingdom ..	Income tax	Profits taxes	Alcohol taxes Tobacco tax
Canada	Profits taxes Income tax		Turnover taxes
U.S.A.	Income tax Profits taxes		

[1] France: Yield of schedular tax, income tax and profits tax together more than 20 per cent. of tax revenue.
[2] Spain: Central government only.

The reasons for this are no doubt partly historical: the "inquisition" of the income tax was for long regarded in many countries, including this, as intolerable. Thus, in many countries, income tax is more prominent as a source of revenue now than at any previous time. But there are other reasons. First, it is only occasionally that a State can reform its public finances. For the most part, Chancellors of the Exchequer and Ministers of Finance must use what they have at hand. There is truth in the adage that "an old tax is a good tax," because an old tax puts least strain on administrative skill and on political tolerance—and these are weighty forces in determining taxable capacity.

In this instance, however, even the convenience of past history does not complete the story. The fact is that income taxes appear to be reaching their peak and two other taxes, though not innovations, have lately acquired increasing prominence: one, the taxation of commodity sales, and the other, the taxation of business profits. Necessity and convenience are undoubtedly part causes for this development. But it is possible that there may also be some deeper logic to it. This is deserving of further examination.

II

TRENDS IN TAXES

In the taxation of commodity sales, or what are known everywhere except in courts of law as "indirect taxes," there are two developments to be noted. First, there is an increased use of what are variously termed "purchase," "sales" or "turnover" taxes which, though not necessarily single rates of tax applied to all the exchange transactions within a country, consist essentially of a small number of rates of tax, each of which is applied to a wide range of goods and services. Secondly, there is the concentration of specific commodity taxes on the two items of tobacco and alcoholic beverages (to which might be added as a special case the item of petrol).

Now, the practical force behind this development is undoubtedly the same as that which earlier made for widespread growth in the use of the income tax: namely, that it is an efficient engine of finance. Nevertheless, at least in academic circles, the income tax has also acquired certain moral or political virtues, and any competitive developments must meet a challenge on these same grounds as well as on those of expediency. Any taxation, whether it reduces incomes or

raises the prices of the things which incomes can buy, forces economies upon the persons subject to it. But, so the argument runs, whereas an income tax leaves the taxpayer completely free as to the manner in which he cuts down his real consumption, an outlay tax, levied on the purchase of some one particular commodity, changes the price of that commodity relative to others and so (unless the demand for it is completely inelastic) puts greater pressure on the taxpayer to economize in that commodity than in any other. From the national standpoint, there may on occasion be special merit in this. Dr. Dalton and Sir Stafford Cripps, for example, made use of the point to try and choke off home demand in the cases of dollar imports and goods needed for export. But, clearly, such a method of raising revenue is additionally burdensome on the taxpayer compared with the income tax and, unless there are these special reasons for its use, unjustifiably so.

Herein is the standard objection to commodity taxes. The forcefulness of this objection is greatly diminished, however, when there are a large number of commodities similarly taxed, for then relative prices are not markedly altered. A *system* of commodity taxes, in other words, takes on many of the characteristics of an income tax, but with two distinctive merits which have lately come to be very important. First, though the system can be made roughly progressive—as is, rather clumsily, the British purchase tax and, more elegantly, the Canadian general sales tax which exempts food and clothing—it does not involve a penal treatment of marginal earnings as does the income tax. Secondly, and more important, it allows savings to be exempted from taxation.

It is an extreme, but defensible viewpoint, therefore, to describe a system of turnover taxes (provided it is well drafted) as being a rather crude income tax which has the important merits of exempting savings and possibly marginal earnings, which the assessed income tax is unable to do. The challenge of the heavy taxation of tobacco and drink is to a certain crudeness in the income tax itself. The higher the rate of income tax, the more important it is to do justice to individual differences in status and personal and family responsibility as between persons of formally the same money income. Yet there are limits to the number of special allowances which can be given in a system of tax assessments without the system becoming excessively inquisitorial and administratively over-costly. The case for the heavy taxation of tobacco and drink is, as Adam Smith hinted long ago, that such goods are not to be classified amongst

the prime necessities of life and payment of taxation on them is therefore " optional " to those who, having the income to spare, can afford to indulge in their purchase—a crude argument, but possibly no cruder than the income tax itself can be in its insensitiveness to the individual.

The development of " profits taxes " or " corporation taxes " is more confused. They have many roots—in the schedular taxes which allow some incomes to be taxed when an entire personal income tax is impossible, in the principle that enterprises should be charged for benefits which are part of costs of production of their products, in mistaken applications of the principle of " ability to pay," and in sheer political prejudice. But here also there comes to the fore, along with the growth of business enterprises, a doctrine about savings.

The theory which regards undistributed profits as simply the saved personal incomes of shareholders no longer holds for the large public company. The policy of its board of directors is largely independent. Consequently, the effects of profits taxation on that policy—and in particular its effects on business saving and investment—should, it may be argued, become the major tax determinant, and possibly the only one. There is much cleaning up to be done—not least in the United Kingdom's arrangements—before this principle is fully established and acted upon. But wherever governments intend to continue to rely upon private enterprises and private investment for their country's economic growth, its recognition would seem to be inevitable.

III

PUBLIC EXPENDITURE

Pressure on taxable capacity derives from the amount of government expenditure to be financed and the use of " budgetary policy " as a means of financing investment and curbing inflation. We shall consider these two elements in turn.

In the U.S.S.R. and Eastern Europe, the public finance structure coincides more or less with the whole economy, and government expenditure and taxation are merged with price and wage policy. In the Western world distinctions are drawn, first between the public and private sectors of the national economy and then between that part of the public sector which is operated " on business lines " and that part financed primarily through taxation. These distinctions are in practice very rough at the edges and the more scholarly writers on

public finance have been greatly exercised to find principles by which their boundaries should be drawn. Their questions—such as why the National Health Service is largely free but not the National Railway Service—provide useful material on which to sharpen one's wits or to test those of one's Member of Parliament.

We are here concerned with the *growth* of public expenditure, however, and to explain this does not require any special law, not even the " law of increase of public functions," discovered by Professor Adolph Wagner in 1893. Public expenditure is composed broadly of three elements: military expenditure, social service expenditure and the costs of administration. It is surely inevitable that all three should grow in absolute terms with growth in national income and population: military expenditure because it is internationally competitive, social service expenditure because of an increasing population requiring existing services and because there are always sub-marginal services pressing for recognition, and costs of administration because these are related to the other two. It is also probable that all three should grow relatively to the national income as national income rises: it is obviously easier to extract a sizeable proportion of any extra income for such purposes than it is to divert income from established private uses. But at what pace?

The growth of public expenditure must be considered in two stages. First, there is " government expenditure on goods and services ": the quantity of real resources which the public authorities appropriate out of the total national product to bestow free of charge upon the public in the social services they enjoy and the defence and police services which enable them to sleep more soundly in their beds. Secondly, there is " total government current expenditure," got by the addition to expenditure on goods and services of " transfer payments," i.e. cash payments to holders of national debt and to the recipients of social security benefits. In the analysis of the use of *real* resources, the effect of these cash transfers falls under the head of private, not government, consumption. Moreover, though they add to the tax burden, they also, unlike direct expenditure on goods and services, add simultaneously to the private incomes from which taxation can be raised: the bond-holder pays income tax on his interest receipt and the old age pensioner pays tax on his tobacco. The net weight of transfer payments on taxable capacity is therefore smaller than their gross weight.

Table II shows the direct claims, pre-war and post-war, made on real resources by " government expenditure on goods and services " in certain Western European countries, Canada and the United States. The figures are of percentages of gross national product. The first half of the table, by relating all figures to the single yardstick of 1949 national products, gives the absolute trends. The second half of the table shows these trends as shares in the national products of their years, thereby allowing for the growth of national incomes as well as of government demands.

TABLE II

GOVERNMENT CLAIMS ON REAL RESOURCES, 1938–1951

Country	Government expenditure on goods and services as percentage of 1949 national product			Government expenditure on goods and services as percentage of current national product		
	1938	1949	1951	1938	1949	1951
	%	%	%	%	%	%
Denmark ..	9	11	13	10	11	11
France	10	12	13	11	12	12
Netherlands ..	6	11	12	9	11	12
Norway ..	6	10	13	7	10	9
Sweden	7	12	14	9	12	12
United Kingdom	10	16	17	13	16	17
Canada[1]	7	13	17	14	13	15
U.S.A.[1]	10	17	27	15	17	19

[1] U.S.A. and Canada: Government expenditure includes items of public investment as well as current expenditure.

The absolute growth in direct government expenditures is apparent for all countries listed in Table II though least for France and Denmark. By 1949, all five Continental countries were deploying some 10–12 per cent. of their national products for government-controlled purposes and this position has been maintained since, except that a substantial absolute growth in Norwegian " government consumption " was more than offset by the advance in national output. The history of the English-speaking countries is different. Their pre-war scale of govern-

ment consumption was above the Continental average; consequently, their post-war growth has been the more remarkable. The " relative " figures for the United States, Canada and United Kingdom in 1952 were 22, 19 and 19 per cent. respectively, compared with 10 per cent. in Norway.

A qualification must, however, be made in respect of the American, and to a less extent the Canadian, figures. In all the European countries, " government expenditure " as recorded is exclusively expenditure on current items, while government capital investment is shown with other investment as a claimant to public and private savings. " Government expenditure " in United States' statistics includes all, and in Canadian statistics includes some government capital investment, with the result that the " government expenditure " figures are so much the higher and the figures of government savings (the budget surplus) are correspondingly lower. This difference in statistical treatment is particularly important when, in the United States and Canada, there has been considerable government investment in " defence facilities."

Allowing for this difference of definition, the United Kingdom's load of direct government expenditure on goods and services stands out as unusually high. Furthermore, only the latest additions to our relative load, those since 1951, are to be ascribed to defence expenditure. In the cases of the Continental countries, services other than defence, though they increased up to 1951 in absolute terms, grew very little as a proportion of current national product, as can be seen from Table III opposite. For these countries, the increases of load, compared with pre-war, were due to greater defence expenditure, even in the case of Sweden. Not so with the United Kingdom. The United Kingdom was carrying quite a heavy defence load in 1938 and, proportionately, it was no higher in 1951 (though it has risen since). Up to 1951, the large relative increase in direct government claims on real resources in Britain resulted mainly from expanded social services and from a greater amount of administration.

The pattern largely repeats itself when transfer expenditure is added to the picture. Direct cash payments—which, it must be remembered, include national debt interest as well as social security benefits—have expanded more rapidly than gross national product only in the United Kingdom, the United States and Sweden. Subsidy payments have risen in relation to the national income only in the United Kingdom and Norway. The combined result is that only in the United

Kingdom did total government expenditure exceed one-quarter of the gross national product in 1951. In all four of the Continental countries listed in Table III (and though data are not available for France they would undoubtedly agree), the proportion was less than one-fifth.

TABLE III

GOVERNMENT EXPENDITURE AND REVENUE, 1938 AND 1951

Percentages of current Gross National Products

1938	EXPENDITURE ON GOODS AND SERVICES			TRANSFER EXPENDITURE			Total expenditure	Surplus	Total Revenue
	Defence	Other	Total	Cash	Subsidies	Total			
Denmark ..	1	9	10	6	—	6	16	4	20
Netherlands ..	2	7	9	8	—	8	17	1	18
Norway ..	1	6	7	4	1	5	12	6	18
Sweden ..	2	7	9	3	1	4	13	6	18
United Kingdom	7	6	13	5	1	6	19	−2	17
Canada ..	..	..	14	8	1	9	23	−3	20
U.S.A. ..	2	14	15	4	—	4	19	−2	18
1951									
Denmark ..	2	9	11	5	1	6	17	5	21
Netherlands ..	5	8	12	6	1	7	19	9	28
Norway ..	4	6	9	4	4	8	17	11	27
Sweden ..	4	8	12	6	1	7	19	8	27
United Kingdom	7	10	17	6	3	9	26	6	32
Canada ..	5	10	15	7	—	7	22	2	24
U.S.A. ..	11	8	19	5	—	5	24	2	26

All figures rounded to nearest unit.

IV
BUDGETARY POLICY

The differences noted above in government expenditure from one country to another and their relation to taxable capacity may well have been significant for our second wing of public finance, that of budgetary policy. For when we turn to the final column of Table III and observe the ratios of revenue raised to gross national products in those countries which have come nearest to following like policies—the countries of North-west Europe—we observe that the extreme position of the United Kingdom, though still apparent, is less marked. Holland, Norway and Sweden were all operating proportionately much larger budget surpluses (inclusive of local government surpluses) than the United Kingdom.[1] Private savings in each of these three countries were also a much larger proportion of gross national product than the United Kingdom could muster. We shall be concerned in this part of our commentary, however, more with the common experiences of these countries than with differences between them.

All European countries have had to contend since the war with two conflicting forces: on the one hand, the widespread demand for capital reconstruction and expansion and, on the other hand, the high consumption demands of fully employed communities, many of them in reaction from war-time austerity. Total capital formation in every Western European country in the years 1947–52 was at an average level which was higher than in any corresponding pre-war period, and the same could be said for most years individually. The object of all Western European governments, therefore, was to achieve these high levels of real investment while at the same time maintaining full employment and also a stable price level. Only in Switzerland, however, where the difficulties were far fewer than for most countries, was something approaching a threefold success achieved, and even here the result was greatly assisted by the existence of a variable number of foreign workers which gave elasticity to the term "full employment."

The extremes of policy were provided by France, on the one hand, and by Belgium, Italy, and Western Germany on the other. Of France's original Monnet plan, only one of the principal objectives was reached by the due date, that for

[1] The United States and Canadian surpluses appear to have been much smaller, but much of this, as observed above, may be the result of the statistical difference that, when the balances for these two countries were struck, some investment expenditure, undertaken by government bodies, had already been accounted for.

petrol refining ; but for the rest, the result was rather two or three years delay in reaching the target than its entire abandonment. Full employment was also maintained. But prices rose rapidly—whether or no as a result of the Monnet plan is disputed—and the cost of living doubled in five years from 1947 with wages successively lagging behind and overtaking the trend of prices. In Belgium, by contrast, the cost of living in the same period rose little more than 20 per cent. ; in Italy, it rose even less ; in Western Germany, in the four years following the monetary reform of June, 1948, retail prices rose hardly at all. In all three cases, this price stability was achieved primarily not by a restrictive taxation policy but by the sharpness of credit control. And it was accompanied by fairly widespread unemployment.

The countries of North-west Europe, including the United Kingdom, have followed different courses from either of these extremes, their methods have been largely similar and their experiences have much in common. In all, full employment has been maintained and a rapid spiral of prices and wages has been avoided. But there has been a steady upward drift in prices which, in the case of the cost of living and in spite of subsidization, amounted over the six years from 1947 to between 30 and 40 per cent. And there has been a recurrent tendency to crises in the balances of international payments. These common results reflect common features of policy : notably, a reluctance to use either prices, interest rates or credit control as the means of restricting excessive demand, and a consequent heavy dependence on budgetary policy to perform this task aided by weakening physical controls.

The original purpose of budgetary policy thus conceived was to restrict consumption demand and thereby to provide government savings in the form of budget surpluses which, added to private savings (mainly savings by corporations), would meet investment requirements to the fulness of physical capacity. Table IV overleaf shows, for the five countries, the amount of investment and the manner in which it was financed in the two years 1938 and 1951 in terms, respectively, of the proportions of gross national resources taken and the (approximate) proportions of the national incomes subscribed. It shows that the expansion of investment was at least as great in private as in public enterprise, but that the part which governments were called upon to play in assembling the necessary savings was greater in all cases, except possibly Denmark. The change

in method of finance was most noticeable in the cases of Britain and Holland which, in 1938, had budgets near to being balanced.

In what circumstances and for how long can consumption be constrained in this way? It is to this question that the fact of a limited taxable capacity has shown itself to be particularly relevant, restricting both the choice of policy and flexibility in its pursuit.

Table IV

GROSS INVESTMENT, AND ITS FINANCING, 1938 AND 1951

Percentages of current gross national products

	Investment					Savings		
	Public Services	Public enterprises	Private home investment	Overseas investment	Total	Private savings	Public savings	Total
1938								
Denmark ..	5	2	12	1	20	16	4	20
Netherlands ..	5	7		4	16	15	1	16
Norway ..	7	3	15	2	27	20	6	27
Sweden ..	8	3	13	2	26	20	5	26
U.K. ..	10			−1	9	11	−2	9
1951								
Denmark ..	5	2	17	—	23	18	5	23
Netherlands ..	5	15		4	24	15	9	24
Norway ..	8	4	18	4	34	23	11	34
Sweden[1] ..	7	4	13	2	26	18	8	26
U.K. ..	4	3	6	−1	12	6	6	12

[1] Sweden: 1949.

First, as to choice of policy. At the end of 1945, Mr. Colin Clark produced a "25 per cent. rule," arguing that, if taxation went beyond 25 per cent. of a country's *net* national income,

> the parliamentarian, banker or administrator, confronted with what he considers excessive taxation . . . becomes, consciously or unconsciously, more reluctant to erect those barriers which, in more normal times, he would erect against rising wages and prices. (*Economic Journal*, December, 1945.)

Now, Mr. Clark's particular figure is of no significance. His calculations were on post-1918 data and the burden of taxation in that period was mainly the result of an abnormal quantity of deadweight debt: there was a revolt against the *rentier* and an inflation of prices and earned incomes reduced the *rentier* burden. Our modern burdens, as we have seen, are largely of a different sort. Nevertheless, the possibility of rising wages as a reaction to high taxation was no less after 1945 than after 1918, and over the six or seven years since 1945 this fact has had a decisive effect on the "plans" of the North-west European countries.

The point is seen most vividly in contrasts with Eastern Europe. There, over-optimism regarding prospective output (a familiar theme) has been a frequent cause of inflationary pressure. But there have been few difficulties from the side of private incomes. The East European governments have manipulated prices freely (with the aid of turnover taxes) in order to equate demand and supply in particular markets; wage-rates have been fixed to achieve a required distribution of labour or to stimulate productivity, without arguments before or after. In the North-west European countries, on the other hand, programmes for the distribution of national resources have been drawn up and proportions earmarked for consumption and for investment. But wages have been left to bilateral bargaining and prices controlled with eyes primarily on the cost of living. The results, encouraged no doubt by movements in world commodity prices, have been steadily rising wage-rates, divergences from what was intended in the use of resources, and a series of balance of payments crises.

The points of budgetary attack had in part, therefore, to be shifted. The attempt had to be made to restrict business profits, which are the background to successful wage claims, and "plans" had to be changed so as to transfer some of the restrictions from consumption to investment. Mr. Gaitskell's budget, for example, was aimed at limiting the receipts which private companies might use for investment expenditure and

Mr. Butler, in his first budget, followed a similar line.

But budgetary policy is not a very efficient instrument for controlling business profits or the demands of private enterprises for capital goods. It lacks directness and it lacks speed of operation. Accordingly, we have seen in the last two years also some change of methods: there has been a partial substitution of credit policy for budgetary restriction.

The conclusion to be drawn from this experience is not at all that budgetary policy is a mistake or a delusion. On the contrary, it has been indispensable in the past eight years and remains an essential element in the contemporary scene. In a deflationary situation, it would immediately take on renewed importance. Moreover, it is at least open to debate whether the more even balance in the demand and supply of resources which has been observed of late in the countries we have been discussing is the product of a revived policy of raised interest rates and credit stringency, or whether it is rather the changed tempo of world trade which has brought an increase in business uncertainty and caution. Nevertheless, there is surely one lesson to be learnt. It is that only in the first paragraph of our modern primer for Ministers of Finance are budgetary policy and "functional finance" a simple matter of social accounting and income manipulation. By the end of the chapter they have become an exercise in budgetary and financial administration which is alike subtle and complex.

R. C. Tress.

University of Bristol.
June, 1953.

Statistics: Explanatory Notes

U.K. 1900 to 1952.—The charts on page 50 depict some of the more important economic trends in this country since the beginning of the century. The output of goods and services per head of the population has increased by about 50 per cent., government expenditure has risen from £4 per head in 1900–01 to £86 to 1952–53, while the value of the pound, taking 1900 as equivalent to 20/-, had fallen by 1952 to about 5s. 6d.

U.S.A. Trends.—Industrial production in April this year was nearly two and a half times greater than pre-war. Defence spending, which rose steeply throughout 1951, has tended to level off since last summer. Although the growth in total consumer credit has also slackened somewhat, credit extended for the purchase of motor cars has continued to increase. Interest rates have tended to harden recently; the yield on long-term government bonds, averaging 2·68 per cent. in 1952, had risen by the beginning of May to over 3 per cent.

World Trade.—Last year, for the first time since the war, saw a check to the expansion in the volume of world exports (first chart, page 52). While the volume of U.K. exports fell by about 6 per cent. compared with 1951, the U.S., on the other hand, recorded a slight increase. The last chart brings out the improvement in our terms of trade that was evident in 1952, due primarily to the fall in the prices of our raw material imports. The corollary of this, however, has been a worsening in the terms of trade for primary producing countries, such as Australia and Malaya.

Sterling Area Trade.—For both the U.K. and the rest of the sterling area imports from dollar countries are about back to their pre-Korea levels, after the upsurge that marked 1951. While our own exports to the dollar area continue to show a gently rising trend, sales by the rest of the sterling area, in contrast, have suffered a sharp contraction from the peak levels of 1951. Even so, the proportion of total sterling exports going to the dollar area was in 1952 still above the 1938 level. From the point of view of the U.S.A., however, sterling countries supplied a lower percentage of American imports last year than before the war.

Banking Trends.—Clearing bank net deposits in May this year were some £170 millions, or 3 per cent., higher than a year previously, although bank holdings of Treasury bills have declined from the peak levels reached last summer. From the last chart on page 54 it will be noted that, although London clearings have risen recently, the Provincial clearings are still running below the early 1951 level.

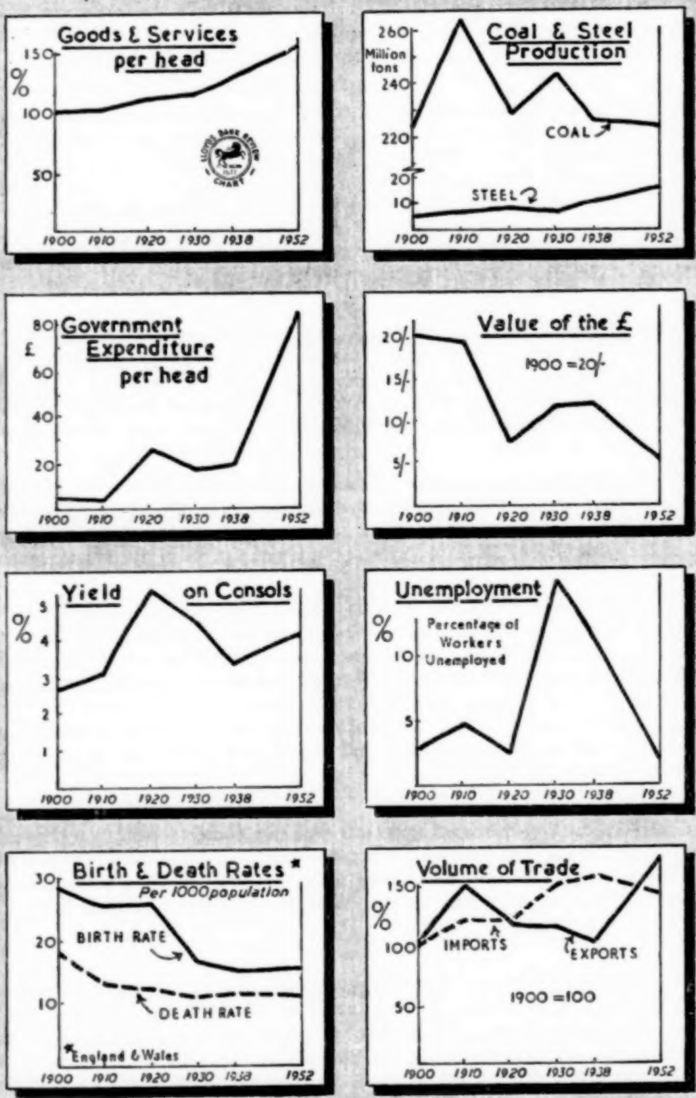
Wheat.—The new International Wheat Agreement which, subject to ratification, comes into force next August, increases the maximum price of wheat by 25 cents to \$2·05 a bushel. The United Kingdom together with the colonies took about a third of the sales under I.W.A. in 1951–52 but is not a party to the new agreement.

Building.—Over the past year there has been a sharp increase in the number of new houses begun, both for local authorities and for private owners, with the result that at the end of March this year houses under construction reached the record total of 278,000, well above the end–1947 figure and 60,000 more than at the same date last year. The number of new factories being built, in contrast, has been declining since the end of 1951. The last chart on page 56 shows expenditure on new housing and on other buildings and works as a percentage of gross fixed capital investment.

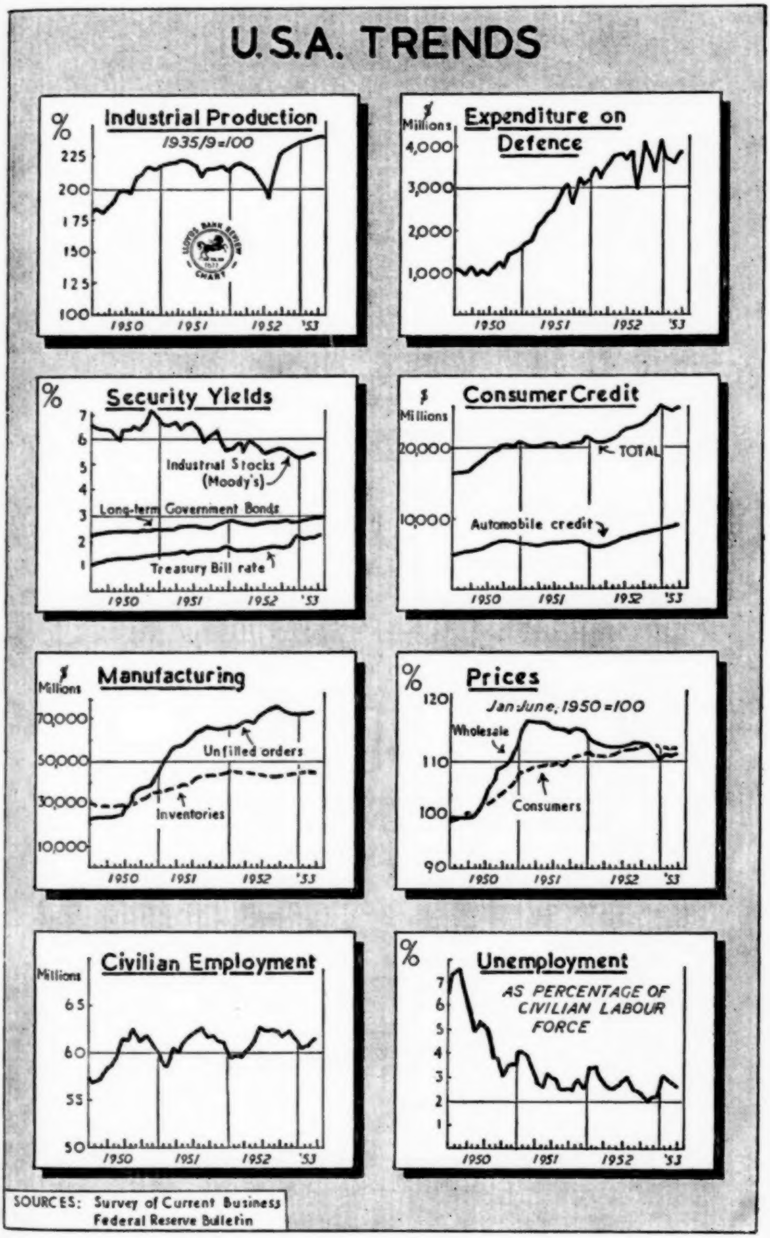
Coal.—Production increased again last year but home consumption showed a slight decline, for the first time since 1947, due mainly to a falling off in demand by industry (page 57). Exports, in contrast, rose by about 4 million tons, although shipments for the year were still less than in 1950. Manpower in the industry also showed an improvement of 17,000.

Textiles.—Home demand for clothing appears to have revived, following the decline in 1951 and early 1952, although textile exports have made only a moderate recovery since last summer. Production has picked up again, accompanied by a marked decrease in unemployment. In June, 1952, unemployment in textiles and clothing represented nearly 10 per cent. of the labour force in these two industries, against a national average of about 2 per cent., but by the end of the year had declined to approximately the same percentage level as the national average.

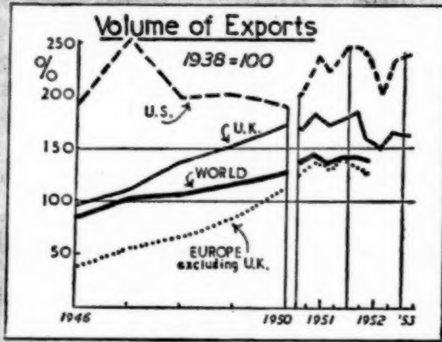
U.K. 1900 to 1952

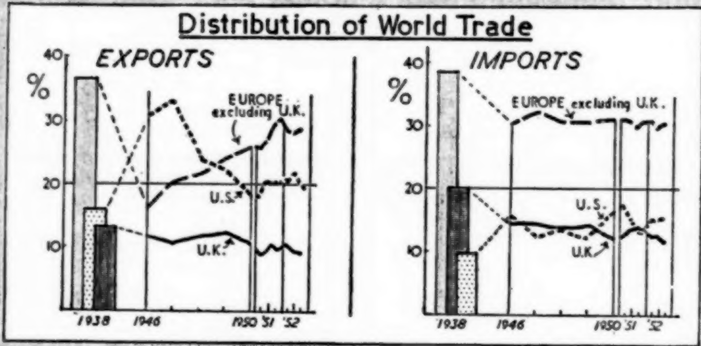


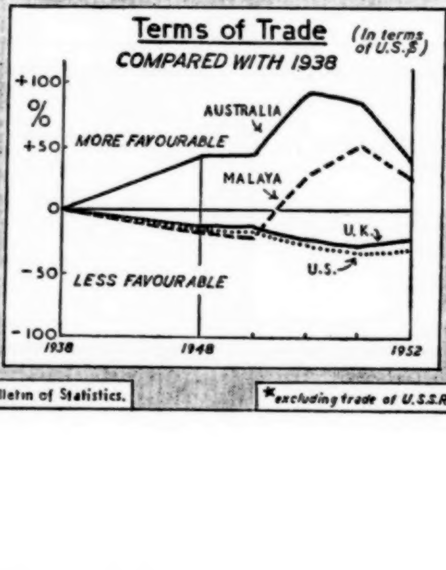
SOURCES: Statistical Abstracts
London & Cambridge Economic Service


U.S.A. TRENDS
Industrial Production
1935/9=100
%
Expenditure on Defence
$ Millions
Security Yields
%
Industrial Stocks (Moody's)
Long-term Government Bonds
Treasury Bill rate
Consumer Credit
$ Millions
TOTAL
Automobile credit
Manufacturing
$ Millions
Unfilled orders
Inventories
Prices
%
Jan-June, 1950=100
Wholesale
Consumers
Civilian Employment
Millions
Unemployment
%
AS PERCENTAGE OF CIVILIAN LABOUR FORCE
1950
1951
1952
'53
SOURCES: Survey of Current Business
Federal Reserve Bulletin

WORLD TRADE *





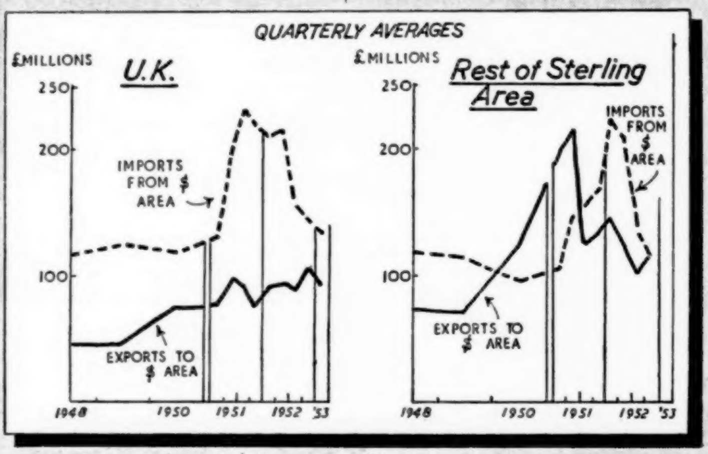


SOURCE: U.N. Bulletin of Statistics.

*excluding trade of U.S.S.R., China & E. Europe

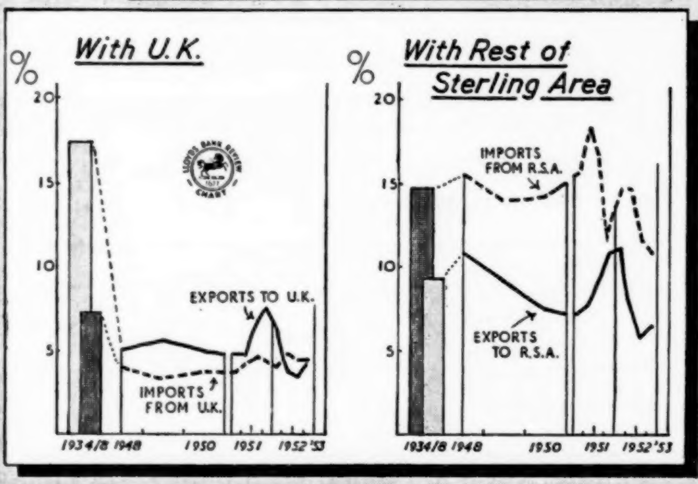
STERLING AREA TRADE

WITH DOLLAR AREA



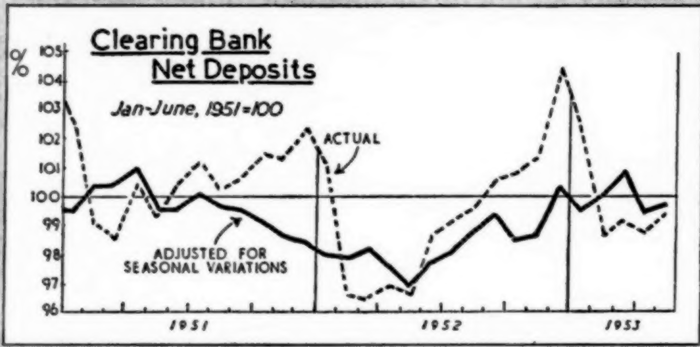
U.S. TRADE WITH STERLING AREA

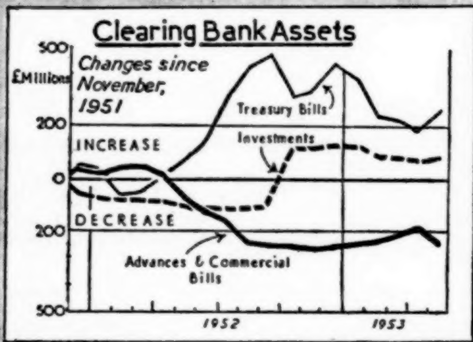
As percentage of total U.S. trade

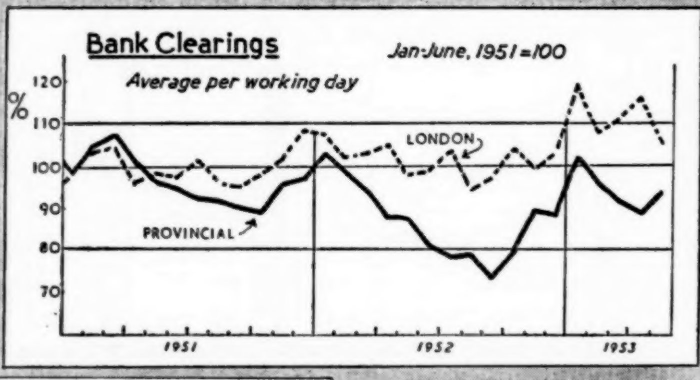


SOURCES: Board of Trade Journal
Report on Overseas Trade

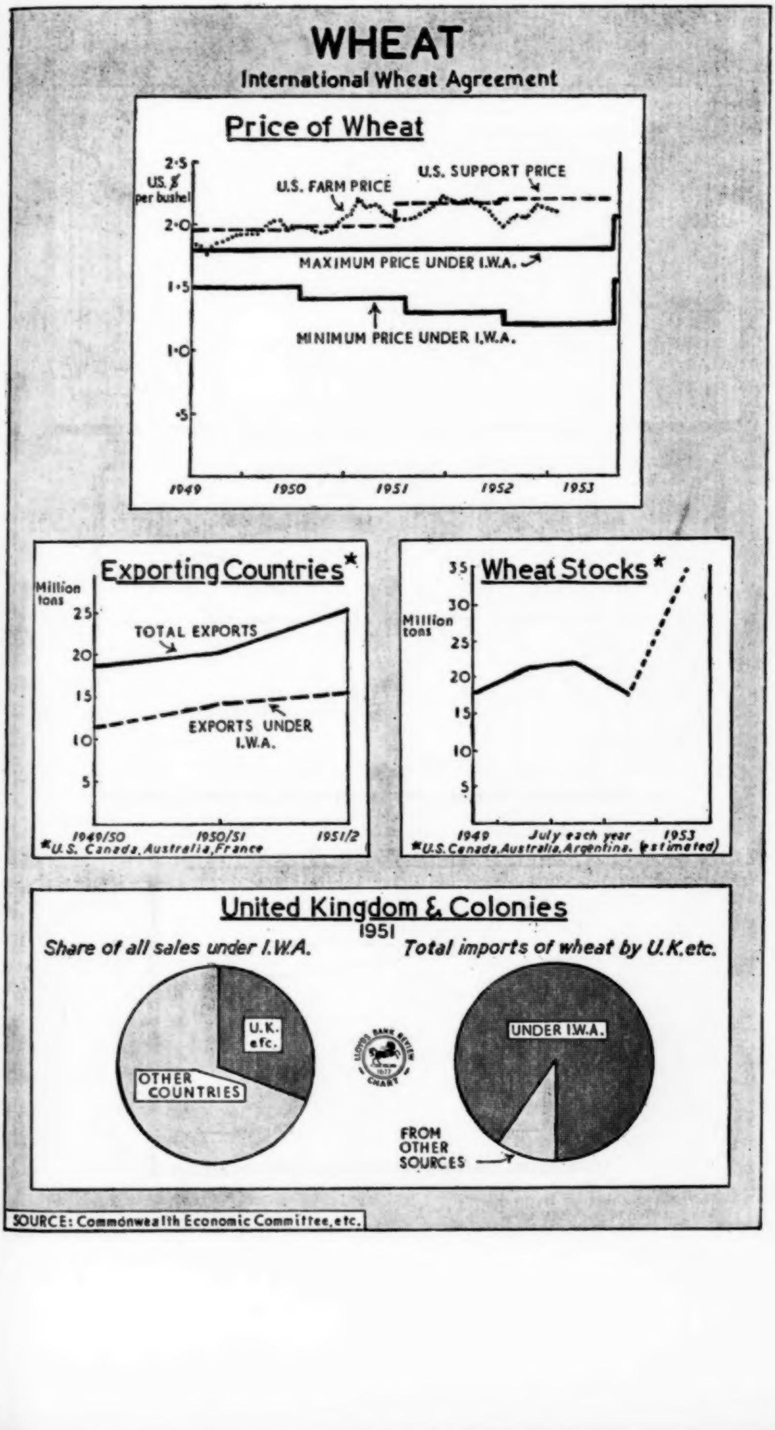
BANKING TRENDS





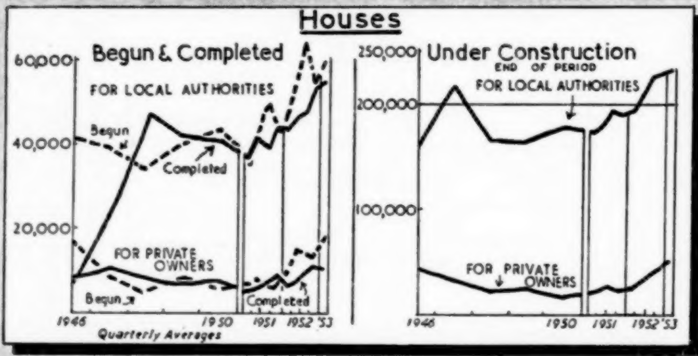


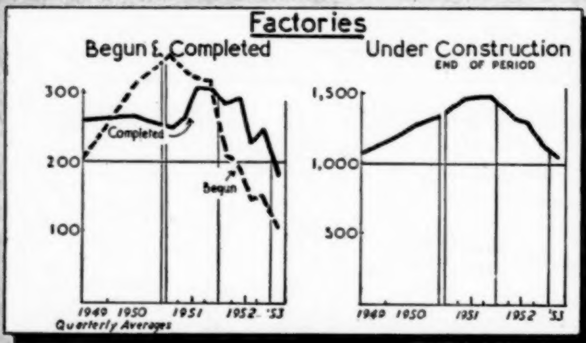
SOURCES: Committee of London Clearing Bankers,
Bankers' Clearing House

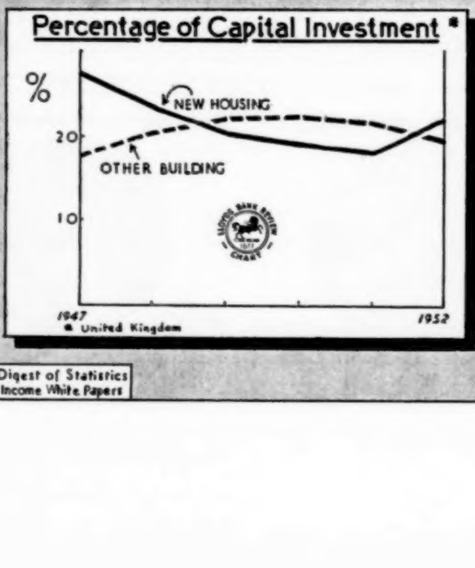

WHEAT
International Wheat Agreement
Price of Wheat
U.S. $ per bushel
U.S. FARM PRICE
U.S. SUPPORT PRICE
MAXIMUM PRICE UNDER I.W.A.
MINIMUM PRICE UNDER I.W.A.
2·5
2·0
1·5
1·0
·5
1949
1950
1951
1952
1953
Exporting Countries*
Million tons
TOTAL EXPORTS
EXPORTS UNDER I.W.A.
25
20
15
10
5
1949/50
1950/51
1951/2
*U.S. Canada, Australia, France
Wheat Stocks*
Million tons
35
30
25
20
15
10
5
1949
July each year
1953
*U.S. Canada, Australia, Argentina. (estimated)
United Kingdom & Colonies
1951
Share of all sales under I.W.A.
Total imports of wheat by U.K. etc.
U.K. etc.
OTHER COUNTRIES
UNDER I.W.A.
FROM OTHER SOURCES
SOURCE: Commonwealth Economic Committee, etc.

BUILDING

Gt. Britain

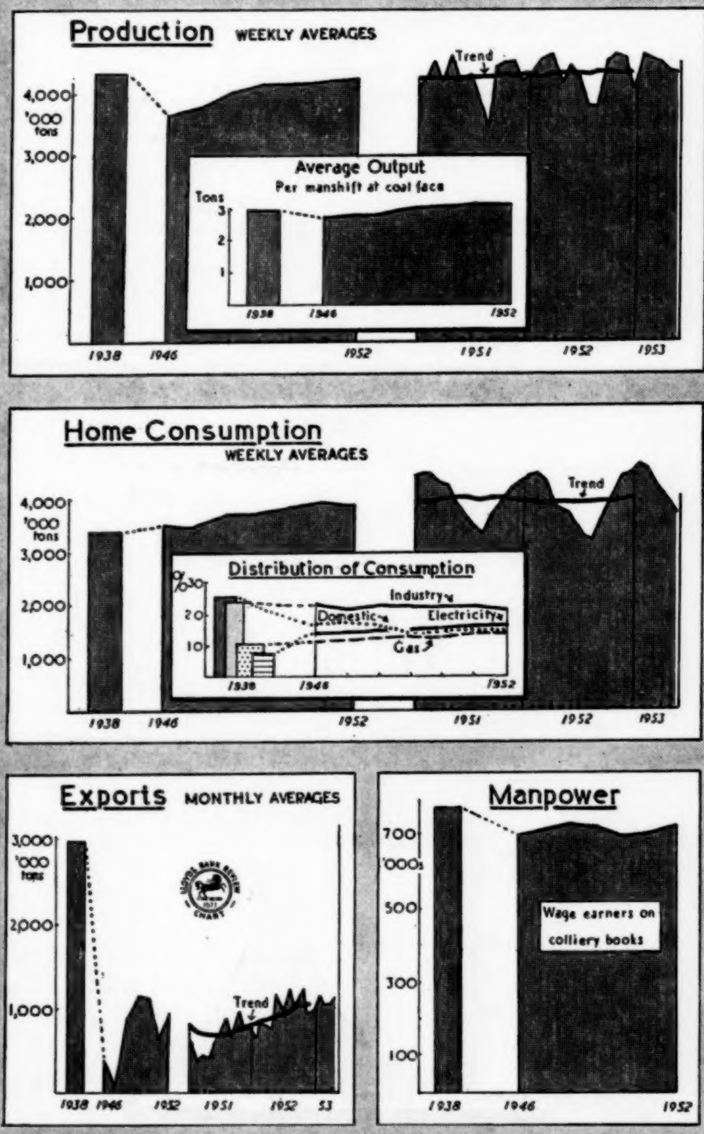






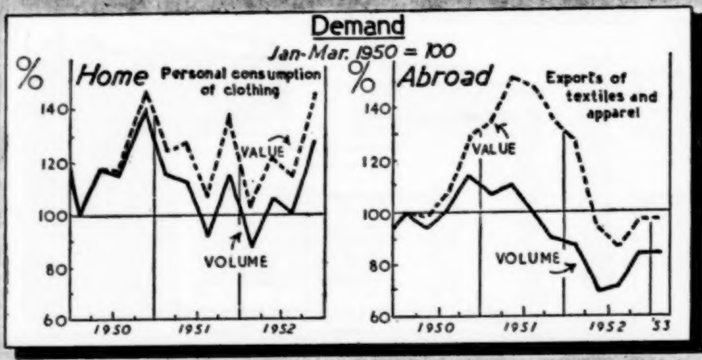
SOURCES: Monthly Digest of Statistics
National Income White Papers

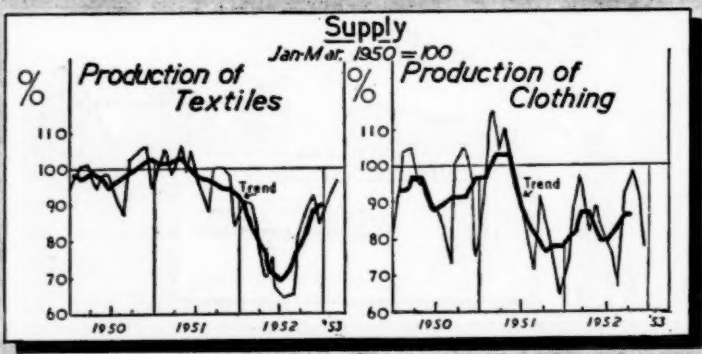
COAL

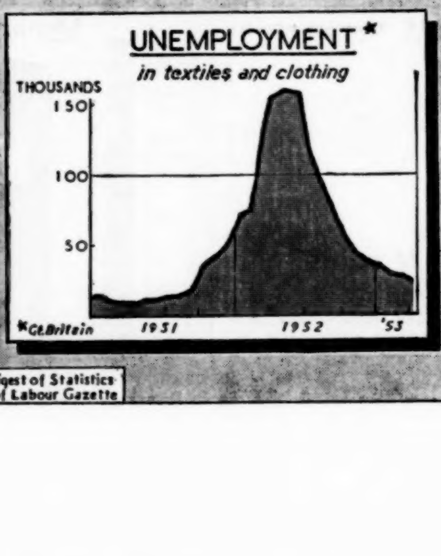


SOURCE: Monthly Digest of Statistics

TEXTILES







SOURCES: Monthly Digest of Statistics
Ministry of Labour Gazette